HARLOW CONSULTING

Advice to Historic Environment Scotland on VAT for listed property in Scotland

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Most repair, renovation and improvement work to existing buildings is subject to Value Added Tax (VAT) at the standard rate of 20%, with certain exceptions. Work on new buildings is zero-rated for VAT, and contractors are not required to charge VAT on labour or materials used. VAT is effectively an extra cost to be taken into consideration by any individuals or organisations who cannot claim it back when they are planning any extension, repair, or maintenance (ERM) work.

There is, therefore, a financial incentive to build new, rather than reuse existing buildings.

Historically a scheme allowed VAT to be claimed back for only new work on listed buildings; for example, extensions but not repairs, but this ended in 2012. Calls have been raised by built environment stakeholders for a VAT rebate scheme to support repair of listed buildings but, as VAT is not a devolved matter, there is no scope to change the way VAT is charged across Scotland.

Historic Environment Scotland commissioned Harlow Consulting to undertake research into the implications of a VAT rebate scheme for work on listed buildings in Scotland. This research has gathered and analysed evidence as to the effect(s) a VAT rebate scheme would make in Scotland, thinking about the potential impact and value (or otherwise).

Research questions

1. How many changes are made to listed buildings each year?
2. What is the monetary value of these changes?
3. Were a VAT rebate to be introduced in Scotland, how much would the approximate cost of refunding VAT payments to works to listed buildings be annually?
4. What sources of government (or other) funding exist or are coming on stream which could be used to help to fund a VAT rebate scheme?
5. What potential impact/ benefits could a VAT rebate scheme have on the regeneration of listed buildings in Scotland?
6. What potential impact/ benefits could a VAT rebate scheme have on helping homeowners maintain their listed buildings?
7. What potential impact could a VAT rebate scheme have on increasing the use of traditional materials?
8. What potential impact could a VAT rebate scheme have on increasing the availability of traditional skills across Scotland?
9. What potential impact could a VAT rebate scheme have on helping Scotland reach net zero, contribute to the circular economy etc.?
10. What potential impact could a VAT rebate scheme have on helping listed buildings be energy efficient?
11. What potential impact could a VAT rebate scheme have on helping to keep the traditional character of listed buildings?

It has not been possible to fully answer all of these questions, because of limitations and gaps in available datasets. Figures included in this report are estimates based on modelling which has drawn upon all available data (explained in Appendix 1), but there are notable gaps in the data sources which must be taken into account when reading this report.

Key messages

The common denominator of the arguments for reducing VAT rates on repair, maintenance, refurbishment, and retrofit is concern that the current differential VAT regime distorts the market in a way that serves to disincentivise keeping existing buildings in good order and to incentivise their replacement by new build structures. The VAT system therefore causes a form of 'market distortion' that results in socially, culturally, economically, and environmentally sub-optimal outcomes that campaigners wish to see addressed through uniform (or at least more uniform) VAT rates for new build and works to existing buildings.

Listed buildings often require highly specialised materials and labour for their repair and refurbishment, both through their intrinsic physical nature and requirements of the statutory heritage protection regime. In previous years, grants and subsidy schemes from heritage agencies

and many local authorities helped fund repair and refurbishment of listed buildings. Increasingly, funding constraints which have worsened over time, have reduced the amount of grant aid available, particularly for private and commercial owners. Consequently, owners of listed buildings must cover the additional costs that come with owning a listed building primarily from their own resources.

In these circumstances, zero-rating or reduced rating of VAT on listed building repairs could readily be seen as a reasonable relief to those additional costs.

There are multiple potential ways of reducing the VAT on the repair, maintenance and retrofit of historic buildings. These can broadly be divided into approaches needing changes to the rates or administration of VAT and those that leave the current VAT system unchanged but allow some form of rebate or grant to be claimed that is equivalent to the VAT paid to HMRC.

The approaches that would require change to the VAT system itself are primarily:

- Introducing reduced rate or zero-rate VAT on works of repair and maintenance (and potentially alteration and extension) carried out on listed buildings.
- Reducing VAT on domestic repair and maintenance work to the 5% reduced rate, an approach that initially attracted attention because it was readily compatible with EU VAT law.
- Introducing a total or partial VAT rebate or reclaim process for customers/end users, similar to that currently available to self-builders.

It should be noted that none of these approaches could readily be introduced only in Scotland, as the VAT regime is outside of the devolved powers of the Scottish government. There is no strong evidence to suggest the UK government is likely to implement any form of VAT system change in the immediate future. This indicates that some form of VAT rebate or reclaim scheme is likely to be the only feasible way of proceeding at present – if a VAT-related measure is deemed to be the right way forward.

There are two basic options for a rebate or grant scheme of this nature:

- Introducing a VAT grant scheme similar to the Listed Places of Worship scheme[1] but available for a wider range of beneficiaries.
- Introducing a mechanism whereby construction contractors would not charge VAT to clients for eligible works but would themselves receive a payment that would cover their VAT liabilities to HMRC.

The advantage of the rebate or grant approaches is that these could be much more precisely targeted than a system-wide change to prevailing VAT rates on repair and maintenance. The corresponding limitation, however, is that it would do less to 'level the playing field' between new build and existing properties.

This research has found an estimated value of annual Extension Repair and Maintenance (ERM) work for Scottish listed property of £377m. The estimated range of total value of ERM work on listed property is between £352m and £401m. Both estimates exclude the value of work in the black economy.

The estimated direct cost of a VAT rebate is £47m. The net cost would be less than this because of the stimulus to the economy and the effect on the black economy. The extent of the stimulus to the economy involves consideration of the elasticity of demand for ERM work on listed buildings and the amount of the rebate which contractors would pass on to clients.

It is clear that there is a need for some sort of stimulus to boost the amount of works undertaken to preserve and sustain listed buildings in Scotland, underpinning the vital conservation of heritage more generally across the country. Listed property owners are delaying essential repair & maintenance works due to a lack of funds; such works would not only sustain their buildings but contribute towards the energy efficiency agenda through actions like introducing moisture management measures, window repair and repointing.

There is a powerful case for change – to preserve skills, the environment, and create stimulus for the economy. It is less clear that a VAT rebate scheme is the optimum way forward.

The VAT system, and its administration, is highly complex. Undoubtedly, the subject of a VAT rebate scheme – and VAT reform more generally – is similarly complex in the sense that there is heavy reliance on certain conditions being in place for any kind of intervention to be effective.

1. Provides grants covering the VAT on repairs of over £1,000 to listed buildings used as places of worship

If a blanket strategy of VAT cuts or rebates is introduced for works on all listed buildings in the hope of meeting specific policy goals, it is difficult to be assured that it will promote those goals without substantial 'deadweight'. In some cases, for example, it will act as an implicit subsidy for works that would have taken place regardless. It may stimulate demand from clients in little need of subsidy, while not being sufficient to support those in most need to undertake works to their buildings. It may restore balance between new build and renovation, retrofit and repair, but the associated removal of the market distortion that results from differential tax treatment may not be sufficient to promote the socially beneficial outcomes sought by government.

Furthermore, any consideration of increased demand is reliant on there being spare capacity in the supply chain to meet that demand. Other considerations are the effect that a rebate would have on the black economy i.e., would contractors currently operating in the black economy shift at least a proportion of their work into the formal economy?

Generally speaking, economics studies acknowledge that a VAT cut (not specifically a rebate, but a cut which amounts to a similar effect of generating more income for consumers) has the potential to stimulate spending, as illustrated below:

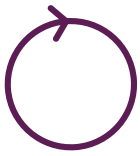
Evidence gathered and analysed for this research suggests a range of positive impacts could be realised as a result of a VAT rebate scheme – **but this is not a linear, straightforward process.** It does not follow that releasing money through a VAT rebate scheme would directly result in more work being undertaken on listed buildings, and the wider benefits which would accompany this.

Income effect

A VAT cut/rebate puts money in the pockets of consumers by reducing their bills. IF these monies are used to make additional purchases, spending and economic activity are stimulated.

Substitution effect

Creates an incentive to bring forward purchases (taking advantage of lower prices during a VAT cut or rebate scheme), acting as a stimulus to demand.



Mutliplier effect

Income and substitution effect boosts output via a multiplier effect – increased demand for workers, in turn stimulating higher employment, higher earnings which in theory further boosts spending.

For a VAT rebate scheme to be effective

Dependencies	Sufficient demand for extension, repair & maintenance (ERM) of listed property	Sufficient skills/expertise in supply chain to meet current and increased demand for ERM	Favourable economic climate	Awareness and trust in a simple to use/ understand VAT system
Current situation	✓ Yes – with demand for ERM likely to increase	✗ No – current supply chain unable to handle existing demand and as it stands would not be able to meet increased demand	✗ Not currently	✗ No – VAT system is highly complex, with some distrust and lack of awareness/ understanding among users of the system
Likely consequences of status quo	Potential issue of deadweight – demand for ERM is high and works may be done regardless of any stimulus **BUT** no guarantees in a difficult economic climate	May result in unintended consequences: sub-optimal work which could ultimately damage heritage properties	VAT rebate may not actually result in desired effect	VAT rebate may not be taken up and therefore have little/no effect

- There is no guarantee that a VAT reduction in itself would lead directly to repair and maintenance work becoming more economically accessible. **Sentiment is positive, but this would not necessarily equate to behavioural change.**
- There are ***potential*** **positive impacts** for the net zero agenda, energy efficiency and preservation of the traditional character of listed buildings were a VAT rebate scheme to be introduced – but there are no guarantees that the benefits would actually be realised.
- There is no guarantee that consumers will spend money saved via a VAT cut/rebate on additional purchases – in this case, commissioning repair & maintenance work. **This is even more uncertain during a challenging economic climate** – and the UK is currently experiencing a cost-of-living crisis. Achieving a stimulus is reliant on price reduction, so if there is some kind of loophole where the tax cut is not passed on to consumers, the impact of a scheme would be greatly reduced.
- There is heavy reliance on having a supply chain in place able to meet increases in demand. Skilled and experienced tradespeople able (and willing) to work on listed buildings and produce outputs with the necessary quality (having been able to source and afford to use the right traditional materials) are in **markedly short supply.**

- It is challenging to cope with current demand; it appears **highly unlikely that the existing supply chain would be able to handle increased demand**. This would severely undermine the value/impacts of a VAT rebate scheme.
- **It is difficult to be assured of sustainability benefits**, as the overall sustainability of existing buildings depends on the quality and appropriateness of the measures implemented, whether of routine repair and maintenance or retrofit – linking back to the skills and supply chain issue.
- There is also the risk that a VAT cut/rebate could result in high amounts of deadweight – i.e., taxes cut or reclaimable on ERM work that would have taken place anyway.

Key considerations

The introduction of a VAT rebate scheme, or indeed any form of VAT reform, is likely to have limited impacts if other key issues are not addressed first

- Any increase in potential demand for ERM works on listed property will place demands on the supply chain. There is little or no spare capacity. Contractors report long pipelines of work. There are skills shortages in construction generally and these are particularly acute in the specialist heritage sector.
- A stimulus to demand without spare capacity would stress the supply chain and potentially lead to inflation, and the rebate being absorbed by increase in contractors' prices. There are also other risks of unintended consequences, if less skilled contractors are attracted by an increase in demand, potentially leading to sub-standard or inappropriate works being carried out.

Therefore, the first priority must be tackling the skills gaps and shortages in the supply chain

- This could involve advocating for additional funding for training courses (noting that there are severe limitations in supply of relevant training in some parts of Scotland, notably more rural areas), funding and support for apprenticeships, and/or other forms of support such as mentoring, traineeships or similar.
- Lack of skilled people in the supply chain is a substantial problem, and not one which is likely to be resolved quickly. It is also an issue that would require multiple actors to influence change, not just Historic Environment Scotland. Other key stakeholders would include funding bodies, the Scottish government and colleges/ training provider networks, as well as industry.

It should be noted that VAT reform is not the sole solution, or indeed may not be the optimum solution – other policy instruments could be considered

- A VAT rebate is essentially a blunt instrument used to solve a complex set of problems, other initiatives could be considered to be used alongside or instead of a VAT rebate. It is important to recognise that success associated with a VAT rebate or VAT reform more generally is heavily reliant on a specific set of circumstances – notably having sufficient supply of skills to respond to the increased demand, and the will of consumers to actually use additional monies for ERM work. The first will require significant time and investment, while the second is dependent on many factors including the economic climate – which is outside of the control of organisations like Historic Environment Scotland.
- General VAT reform could be considered to level the playing field between new construction works and ERM. It would rely on UK government support, and the timescale for implementing this would be longer, it would not be a quick win.
- The most effective solution may be a coordinated policy 'toolbox' rather than individual policies implemented in isolation; there are still no guarantees that a range of policy interventions would work in the current context.
- These could include direct grants for ERM work; and free or subsidised access to professional advice. Further research would be required to assess how such grant aid would be funded, and through which bodies.
- Regardless of the instrument(s) used, to avoid deadweight i.e., refunding VAT on works or grant aid where this provides little societal benefit e.g., on new kitchens and bathrooms, a more targeted approach should be considered, where support is only available for works for which there exist backlogs and which are crucial to a low carbon agenda or are necessary to halt deterioration, such as work on windows, roofs, and/or repointing. Support could also be means-tested.
- There should be consideration of whether any form of intervention is permanent or temporary. If temporary

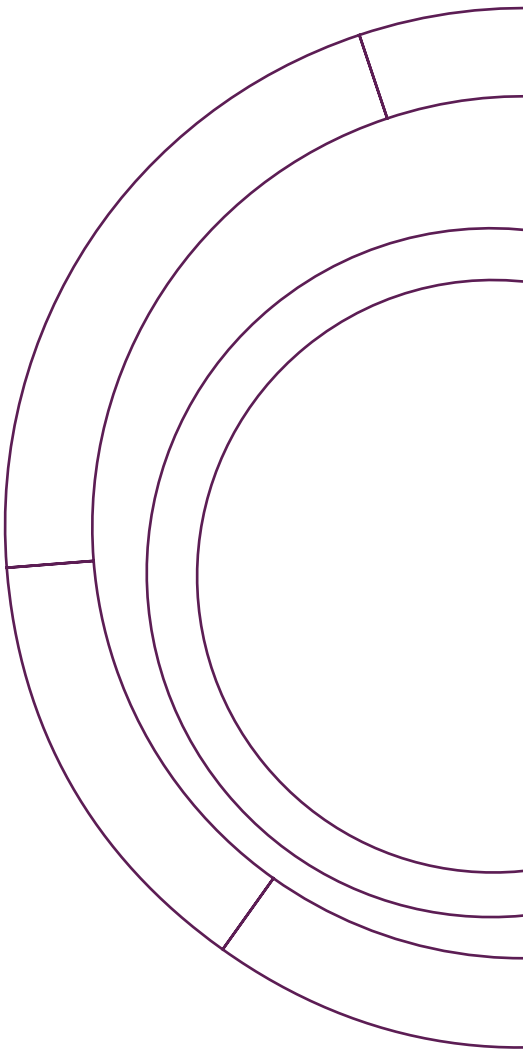
there is a risk that prices will increase when a scheme ends. Contractors are wary of 'stop start' policies which confuse and undermine long-term planning.

Potential consumers must be made aware of any form of VAT rebate, reform or indeed any other intervention for impact to be realised and maximised

- For any intervention to work, potential consumers need to be aware of it. Further research is likely to be needed into the potential impacts and approaches to implementation of other policy instruments such as grant funding, but regardless of the approach – it must be accompanied by a consumer awareness campaign targeting the wide range of owners of listed property. Alongside awareness of any new interventions, consumers should be made aware of other existing grants or funding for which they are eligible. For funds to be spent effectively it is essential that consumers have some technical knowledge of what constitutes appropriate works for listed property; there should be signposting or an education campaign.

This report should be viewed as the first step in understanding this complex issue and actions that could be taken

- This research has been complex, with challenges in its implementation – notably limitations in the availability of data. Further research may be required to test potential impacts of alternative approaches. Future studies should seek more detailed insights from developers to ensure a rounded perspective.
- Research of this type could be carried out more effectively if more specific data were in the public domain.
- An overview of all Scottish Listed Building Consent planning applications would be helpful, currently these are aggregated with Conservation Area Consent applications.
- Analysis of planning data would be more accurate if there was consistency across all planning authorities in terminology for planning decisions, successful applications are variously referred to as e.g., 'Approved', 'Granted', 'Deemed Approved'.
- Publicly available data covering listed buildings is scarce. For this research data from commercial provider Verisk was used to calculate relative areas of domestic and non-domestic listed buildings. Publicly available data including area, condition; type i.e. domestic/ commercial; and ownership i.e. private/public would have been helpful.
- Detail covering EPCs for listed buildings could inform any future research concerning Scotland's net zero future.
- ONS data covering Repair and Maintenance includes domestic extensions but excludes non-domestic extensions, this causes some difficulty when attempting to arrive at aggregate figures for Extension, Repair and Maintenance. Consistent data would help to simplify analysis and potentially improve the accuracy of outputs.



1. Introduction

1.1 The need for this research

Most repair, renovation and improvement work to existing buildings is subject to Value Added Tax (VAT) at the standard rate of 20%, with some exceptions.[2] Work on new buildings is zero rated for VAT, and contractors are not required to charge VAT on labour or materials used. VAT is effectively an extra cost to be taken into consideration by any individuals or organisations who cannot claim it back when they are planning any extension, repair, or maintenance (ERM) work.

There is, therefore, a financial incentive to build new, rather than reuse existing buildings.

Historically there was a scheme allowing VAT to be claimed back for only *new work* on listed buildings – for example, extensions but not repairs, but this ended in 2012. Calls have been raised by built environment stakeholders for a VAT rebate scheme to support repair of listed buildings – but as VAT is not a devolved matter, there is no scope to change the way VAT is charged across Scotland.

Historic Environment Scotland have commissioned Harlow Consulting to undertake research into the implications of a VAT rebate scheme for work on listed buildings in Scotland. The aim is to gather and analyse evidence as to the effect(s) a VAT rebate scheme would make in Scotland, thinking about the potential impact and value (or otherwise).

If the full amount of 20% VAT is rebated this would mean those commissioning work would be paying 16.7% less than they would otherwise.[3] The magnitude of the effect of the rebate is a function of the price elasticity of demand for ERM, (i.e. how much price influences individuals' decisions to commission work) and the baseline amount of ERM work on listed buildings (i.e. the amount of work that is being undertaken annually, without a VAT rebate). The annual cost of the rebate will be equal to the 20% of the cost excluding VAT of all work currently being commissioned annually – the baseline plus the cost excluding VAT of any increase in work commissioned.

1.2 Research objectives

The objectives are for the research to answer the following questions:

1. How many changes are made to listed buildings each year?
2. What is the monetary value of these changes?
3. Were a VAT rebate to be introduced in Scotland, how much would the approximate cost of refunding VAT payments to works to listed buildings be annually?
4. What sources of government (or other) funding exist or are coming on stream which could be used to help to fund a VAT rebate scheme?
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8. What potential impact could a VAT rebate scheme have on increasing the availability of traditional skills across Scotland?
9. What potential impact could a VAT rebate scheme have on helping Scotland reach net zero, contribute to the circular economy etc.?
10. What potential impact could a VAT rebate scheme have on helping listed buildings be energy efficient?
11. What potential impact could a VAT rebate scheme have on helping to keep the traditional character of listed buildings?

It should be noted that, due to gaps in available data and evidence, it is not possible to fully answer all of these questions, but where possible, the research team has derived estimates using a range of data sources synthesised for the purpose of this research. More detail is provided in Appendix 1.

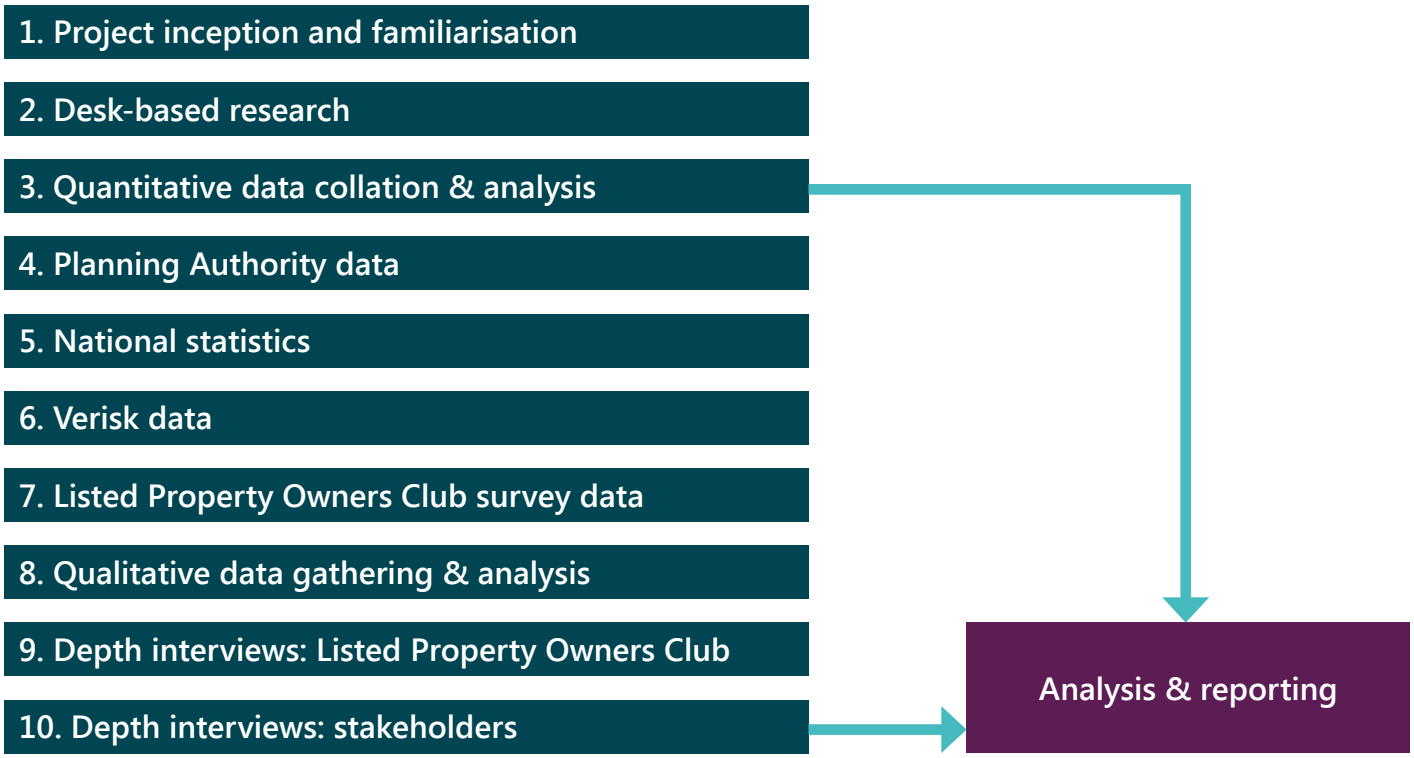
2. Gov.uk VAT for builders lists exceptions as:
- work for disabled people in their home;
- installing energy saving products and certain work for people over 60;
- converting a building into a house or flats or from one residential use to another;
- renovating an empty house or flat;
- home improvements to a domestic property on the Isle of Man; and
- work on some buildings that are not houses or flats.

3. VAT inclusive price of P = (ex VAT price x 1.2) hence VAT refunded is P - (1/1.2 x P) = .167P

1.3 Research methodology

An overview of the research methodology is provided below, more detail can be found in Appendix 1.

We are very grateful to the management team at the Listed Property Owners Club for enabling our survey to be distributed among its members in Scotland, and to the listed property owners who took the time to provide their input.



1.4 About this report

- This report begins with an explanation in Chapter 2 of how VAT works generally – noting the complexity of both the system as a whole as well as its administration – then describes further detail of how VAT operates in property and construction.
- Chapter 2 also sets out the case for change, thinking about sustaining heritage, skills, and the environment, as well as stimulating the economy through a VAT rebate scheme.
- Chapter 3 outlines approaches which have been used to reduce the VAT requirement, and how potential impacts may be realised.
- Chapter 4 presents our calculations of the values associated with a VAT rebate scheme (detail about the modelling used for this purpose is explained in the research methodology).
- In Chapter 5, the evidence of potential impacts of a VAT rebate in Scotland for listed buildings is explained.
- Chapter 6 summarises the key messages, while Chapter 7 sets out our considerations for Historic Environment Scotland.
- Appendix 1 explains the research methodology and modelling in detail.
- Finally, Appendix 2 shares the profile of the survey data respondents.

Research context

2. Research context

2.1 VAT and historic buildings

2.1.1 VAT – history and functioning

The UK has long had various forms of consumption tax, beginning in the seventeenth century with excise taxes, which came to be levied on a number of household necessities, basic commodities, and certain luxuries, such as salt, candles, beer, and tobacco, levied at the time of manufacture. By the late eighteenth century, excise duties accounted for more than half of government revenue.[4]

The most important sales tax, and the direct predecessor of the current VAT system, was the 'purchase tax'. This was introduced in 1940 to differentially tax the wholesale cost of items according to their perceived degree of 'necessity' or 'luxury'. The aim was to disincentivise the purchase of unnecessary goods and services and so reduce 'wastage' at a time when the economy was required to direct as much as possible of its potential productive surplus towards the war effort. The tax, however, outlasted this initial purpose, its moralistic dimension aligning well with the idealistic politics of the post-war period, when the welfare state in its current form was established.

The purchase tax was replaced by the much simpler VAT system when the UK joined the European Economic Community (EEC) in 1973. As part of the process of economic alignment between the EEC member states, the First and Second VAT Directives of April 1967 required that any sales tax levied in a member state should adhere to the same basic structure, while continuing to allow wide latitude in the actual administrative mechanisms used and rates set. Subsequently, the Sixth VAT Directive of 1977 started moving towards greater harmonisation, but resistance from the major EEC states, including France, Germany, and the UK, ensured that this did not extend to the rates themselves.

In the 1980s and 1990s, however, plans to establish a barrierless 'internal market' within the EEC led to renewed attempts to harmonise rates between member states. A 1985 White Paper stated that 'provisions should be adopted which will exclude the proliferation of VAT rates in Member States, or the widening of the gap between VAT rates, since this would make subsequent adjustment more difficult.'[5] Subsequently, a series of initiatives to reduce the divergence between rates and structures were developed but only partially implemented, giving rise to the current EU system, of which the UK's VAT regime is a legacy.

4. Daunton, *Trusting Leviathan: the Politics of Taxation, 1799-1914* (2001), pp. 36.7, quoted in H. Yeomans, 'Taxation, State Formation and Governmentality: The Historical Development of Alcohol Excise Duties in England and Wales', *Social Science History,* 42 (2): 269-293 https://eprints.whiterose.ac.uk/112466/3/YeomansTaxation%2C%20State%20Formation%20and%20Governmentality.pdf

5. Quoted in R. de la Feria, 'Blueprint for VAT Rates in Europe', *Intertax*, 43 (2) (2015): 155-172 https://eprints.whiterose.ac.uk/135598/1/RdelaFeria-VATRates-Intertax-Nov2014-Final.pdf

The ideal towards which the Commission hoped to push the EU's member states was uniform application of a VAT rate of no less than 15% on all goods and services. It soon became clear, however, that, in the 1990s, as in the 1970s, the leading member states were not willing to give up the freedom to charge differential rates for social policy purposes. The approach ultimately taken was therefore to develop a framework that would define where, and to what extent, such differential rates could apply.

The result was the current EU system, which requires that there can be no more than three VAT rates in a member state: a standard rate, to be no less than 15%; and up to two reduced rates, the lowest of which must be 5% or more, which can be levied on a range of goods and services specified in Annex 3 of the VAT directive. Since 2009, EU law has allowed repair, maintenance, and improvement to private dwellings to benefit from the reduced rate. Some goods and services, however, are required to be VAT-exempt, meaning that they stand outside the VAT system altogether, and there is flexibility for some additional goods and services to have this same status.

In addition, however, some specific countries which had previously charged lower rates on goods and services not included in Annex 3 have been allowed to retain them by special exception. These can be subject to a 'super-reduced rate' of less than 5% or a zero-rate; and some countries have been allowed to continue applying an 'intermediary' rate of no less than 12% to goods and services as well. In practice, moreover, the system is even more complex due to the persistence of other legacy or special schemes within certain member states.

Although, since Brexit, the UK is largely no longer obliged to adhere to EU rules. The UK government has nevertheless retained the pre-Brexit domestic VAT system unchanged and has given no indication of any intention to change this in the future. A particular challenge in this respect is the special status of Northern Ireland. In order to retain barrierless trade and freedom of movement with the Republic of Ireland – an EU country – the Northern Ireland Protocol requires that EU VAT rules continue to apply in the province. Change to VAT rates and rules in the rest of the country would therefore lead to further divergence between Northern Ireland and the mainland, with such divergence already the main source of the current breakdown of the power-sharing government in the province. This provides a strong political disincentive for substantive change to the current UK VAT regime.

2.1.2 VAT rates in the UK

The basic operation of VAT in the UK is, in theory, straightforward: almost all goods and services are subject to a flat-rate sales tax (currently set at 20%) on their last sale before consumption.

In reality, the system is extremely complex. To begin with, the UK had previously taken advantage not only of the flexibility to charge reduced rates of VAT but also of the concessions that permitted retention of a number of legacy lower rates on specific goods and services. This means that VAT is not charged uniformly at the standard rate. It is also not charged at all on some goods and services or in certain circumstances, either because they are 'zero-rated' (i.e., subject to VAT but at a tax rate of 0%) or because they are exempt from VAT.

The two cases result in different tax treatments: in the former case, input VAT is recoverable, as the transaction is part of the VAT system; in the latter case, the transaction is not part of the VAT system at all, meaning that input VAT cannot be reclaimed.

There are also certain goods and services and/or specific circumstances where VAT is charged, but at a reduced rate, generally 5%. This means that there have to be rules to determine whether specific goods or services, or the particular circumstances, do or do not fall into the relevant VAT categories.

Finally, there are also some special VAT treatments for specific types of business. Most importantly, traders in most second-hand goods, antiques and works of art can use a 'margin scheme', where tax is charged not on the retail price but on the margin between the cost and the sale price of the items being sold (at a rate of 16.67%). This VAT is not recoverable in any circumstances.

2.1.3 VAT schemes

The administration of VAT is also complex. The difficulty of determining when goods or services are finally being consumed means that VAT is charged by default on almost all goods and services not only at the point of final sale but throughout the supply chain. Those consuming goods and services not as final consumers but as producers of other goods and services can then reclaim the VAT on those that qualify as 'inputs'.

In most cases, this is a matter of separating those purchases that are specifically and solely incurred for business purposes – i.e., to enable the purchasing business to supply goods or services, rather

than for personal use or business entertaining, and pro-rating the amount of business and non-business use for other assets. This is not always immediately clear, however, so there have to be rules that define where VAT can be reclaimed and where not.

There are also special arrangements for large capital expenditures, to take into account the potentially variable degree of business use of an asset over a relatively long expected lifespan. In other words, it is not enough for VAT paid on the asset to be refunded in accordance with its use immediately after purchases.

The administrative and financial burden of monitoring every individual transaction for VAT paid or charged and then working out the extent which each input qualifies for repayment is such that the UK government does not expect every business to administer VAT in this way. Businesses turning over less than £85,000 a year are not required to register for VAT at all. This means that they do not have to add VAT to their invoices but they are also unable to recover VAT paid on their business inputs.

As soon as a business reaches this 'VAT threshold' it must register for VAT. Even then, however, the UK government also operates a number of simplified VAT 'schemes' for smaller businesses. By this means they can avoid having to track the VAT charged on every individual purchase or sale. For example, businesses turning over up to £150,000 per year can choose to remit to HMRC a flat rate percentage of their total turnover inclusive of the VAT they charge their customers ('VAT-inclusive turnover'). This is taken to satisfy the business's VAT obligations to HMRC. This rate should always be less (though sometimes only marginally so) than the total amount of VAT charged by the business to the consumer. This means that the business does not have to recover VAT on individual inputs, but instead gets to keep a defined proportion of the VAT charged to consumers. The benefit of the flat rate system is far greater administrative simplicity for both businesses and HMRC, but with the risk that the business may sometimes pay more, or HMRC receive less, than if the reclaimed amount was calculated in full. There are also various schemes to make administration of VAT simpler and easier in specific circumstances, notably in the retail sector, catering, and floristry.

In addition, there are special ways of administering VAT in some sectors where there have, historically, been particular problems with non-compliance, whether intentional or inadvertent. The most common way of dealing with this is that in some specific situations and sectors it is the purchaser, rather than the supplier, who must pay VAT on the purchase price at the prevailing rate. This is to prevent the 'missing trader' problem, where firms are wound up immediately after work is completed and the VAT charged is not paid to HMRC.

Larger firms not within scope of one of these schemes must calculate their VAT liability precisely by tracking the VAT charged on supplies and the VAT paid on their allowable inputs. The frequency with which they must calculate their overall liability to HMRC and make payments depends on the size of the business. The default model

is through submitting and settling quarterly VAT returns.

Smaller businesses (currently turning over up to £1.35 million per annum or, subsequent to registration, up to £1.6 million) have alternative options of:

- 'cash accounting', where the business pays VAT when it is received with customer payments and reclaims VAT when it is paid on eligible inputs.
- 'annual accounting', where VAT is calculated and settled once, instead of four times, a year.

Firms paying large amounts of VAT to HMRC (in excess of £2.3 million annually) must make quarterly returns and payments on account every two weeks towards their annual VAT bill.

2.1.4 VAT on property and construction

The administration of VAT in the construction sector is especially challenging to deal with because almost all the complicating factors discussed above apply. This begins with the rates charged for construction work and on property transactions: not only are all four VAT statuses – and in specific circumstances the margin scheme – relevant to construction and property goods and services, but there are special arrangements that enable input VAT to be reclaimed in circumstances where it would not otherwise be recoverable.

VAT status of different types of property and construction work

All four VAT major statuses – standard, reduced, zero-rated and exempt – apply to property and construction work, depending on the nature of the work.
In addition, there are various special schemes or circumstances that allow input VAT to be reclaimed where it would more usually be irrecoverable.

Standard rate (20%)

- Construction of new commercial buildings.
- Sale of new (three years or fewer after completion) commercial property.
- Repairs, maintenance, alteration, and extension to existing (more than three years old) residential property.
- Repairs and maintenance to existing (more than three years old) commercial property.
- Supply of professional services associated with development of property, even where the property being developed is zero-rated, reduced rated or exempt.

Reduced rate (5%)

- Conversion of a non-dwelling into a dwelling.
- Division of a dwelling into more than one dwelling.
- Combining two or more dwellings into a single dwelling.
- Converting a number of dwellings into a different number of dwellings.
- Refurbishment or alteration of empty dwellings that have been empty for two years or more.
- Installation of certain grant-funded heating equipment work (in England or Wales only, as the relevant grant schemes are only available in England and Wales).
- Installation (and associated supply) of certain mobility aids for people aged over 60.

Exempt

- Sale of existing (more than three years old) residential property.
- Sale of existing (more than three years old) commercial property (unless the owner 'opts to tax').

VAT rate

20%

Standard

- Letting of residential property.
- Letting of commercial property (unless the landlord 'opts to tax').
- Letting of dwellings converted from commercial buildings (unless the landlord 'opts to tax').

Zero-rated (0%)

- Construction works to build a new dwelling or dwellings (not including alteration, conversion, reconstruction, enlargement, or extension of an existing building, except where retention of the principal façade, or two principal façades in the case of corner sites, is a condition of planning consent).
- First sale of a 'major interest' (freehold or long leasehold) in a new residential property.
- First sale of a 'major interest' (freehold or long leasehold) in a commercial property newly converted into dwellings.
- First sale of a 'major interest' (freehold or long leasehold) in a protected (i.e., listed or scheduled) building substantially reconstructed from the shell.
- Construction and sale of relevant residential properties (RRP) that are not 'dwellings' (comprising various types of special residential accommodation, generally institutional, such as children's and care homes, boarding accommodation for schoolchildren, armed forces housing, monasteries, and nunneries).

- Construction and sale/leasing of a building, or annexe of a building with a separate entrance and capable of being used independently, that is used for a relevant charitable purpose (RCP). RCP property is defined as charitable by use, not ownership status (so a property used for commercial purposes, such as a shop, that is owned or leased by a charity is not zero-rated, but a property that is used for charitable purposes, even if run by a business, will be). This status can apply, at the discretion of a charity that has leased or purchased the property and that will be using it for a relevant charitable purpose, even where an owner has 'opted to tax'. It should be noted that use of a premises as an 'office' for administering the charity is not an RCP but using an office in direct fulfilment of a charitable purpose (for example for providing counselling or as a call centre for taking donations) would be.
- Supply of certain construction services for improving accessibility and useability of buildings for disabled people:
  - installing a ramp or widening an existing doorway or passageway, but not converting a window to a doorway), in a disabled person's own home or any building owned by a charity.
  - providing, extending, or adapting a bathroom, washroom or lavatory to suit the condition of a disabled person in that person's own home, or for charity where the building where the work is taking place is residential accommodation or a day centre where at least one-fifth of the individuals using the centre are disabled persons.
  - providing, extending, or adapting a washroom or lavatory (but not a bathroom) for use by a disabled person in a building used principally by a charity for a relevant charitable purpose.
  - installing or maintaining a lift for use by a disabled person in their own home or in a day centre or temporary or permanent residence for disabled people (but not in other types of charity building).
  - the supply of chair or stair lifts and lifts in charity buildings where they are designed for use by disabled people and where the lifts have been installed to meet the needs of specified disabled people.
  - supply and repair and maintenance of a qualifying emergency alarm call system.
- Standalone installation in, or in the curtilage of, residential accommodation of:
  - certain energy saving products, including associated works ('ancillary supply') required by the installation.[6]
  - supply of those products where the installer is also the supplier.

(This rate applies until 31 March 2027).

Special situations where VAT is recoverable

- DIY housebuilders can claim a refund of the VAT on certain construction goods and services for the construction of a new home or the conversion of an existing non-residential building into a home.[7]
- Landlords who are VAT-registered for whom letting exempt property is *part* of a wider business and whose exempt (normally irrecoverable) input VAT is, on average, a) not more than half their total input VAT liability; and b) not more than £625 per month (equating to £1,875 a quarter or £9,375 per year), can reclaim their input VAT.[8]
- Option to tax. It is possible for landlords of commercial properties (not dwellings) that would otherwise be exempt from VAT to 'opt to tax'. This means that input-VAT becomes recoverable, but that VAT is also charged on sales, leaseholds, and rentals. Once a business has opted to tax and not changed the decision within a six-month 'cooling off period', it remains within the scope of VAT for twenty years. The status can be disapplied where a charity wishes to use the building solely (100%) or, by agreement of building owner and charity, almost solely (95% or more) for a relevant charitable purpose. The charity must issue a certificate to the landlord confirming that it will be using the building for this purpose.

Margin scheme

- This has no special relevance to the construction and property sectors, but dealers in architectural salvage and second-hand building materials may choose to apply the margin scheme on all or some of their sales (paying 16.67% on the difference between cost and sale price rather than standard rate VAT on their sale price, while not being able to recover input VAT on items purchased for stock through the scheme).

6. https://www.gov.uk/tax-on-shopping/energy-saving-products
7. https://www.gov.uk/guidance/goods-and-services-you-can-claim-for-under-the-vat-diy-scheme
8. https://www.gov.uk/guidance/partial-exemption-vat-notice-706#section11

Some of these schemes appear to be well-known and routinely made use of. The margin-based 'special scheme' is widely used in the second-hand goods and antiques trades, and informal sampling of websites for architectural salvage dealers suggest that it is frequently used within the sector. Commercial landlords seem to be well aware of the 'option to tax'. Since new construction is largely the domain of large and medium-sized enterprises, it is reasonable to presume that the new build zero-rate is almost completely taken advantage of. There does not seem to be clear evidence on the extent of take-up of the more complex reliefs; however, the development of specialist VAT advice services charging considerable professional fees – as noted below – implies that only the most well-informed and well-financed developers are likely to take full advantage of them. For example, there is some anecdotal evidence to suggest that there is lack of awareness which may be preventing some people taking advantage of the rebate scheme for conversion of existing non-residential buildings into residential buildings.[9]

2.1.5 Administration of VAT in the construction sector

As with other sectors, individual contractors turning over less than £85,000 per year are not required to register for VAT, and so can offer their services VAT-free, but at the cost of being unable to recover input VAT. At the point where registration becomes necessary (currently those turning over up to £150,000 per year or, subsequently to registration, up to £230,000), construction businesses, like other businesses providing services within the scope of VAT, can opt to pay HMRC a flat percentage of their VAT-inclusive turnover.

As a way of trying to ensure that the proportion reclaimed is fair, different business in different industries and of differing types are subject to different rates of VAT, to reflect the differing proportions of turnover typically spent by a business of that kind on input goods and services subject to VAT. Businesses that have very few inputs (expenditure on goods and services of less than 2% of turnover and/or totalling less than £1000), which must pay almost all the VAT they charge to HMRC (paying 16.5% of their VAT inclusive turnover), while those with very high inputs and/or low liabilities for VAT (because they operate in sectors with reduced or zero-rates of VAT) are required to submit a much smaller proportion of their VAT-inclusive turnover.

There are two flat rates applicable to small construction firms: 9.5% for 'general building or construction services', or 14.5% for 'labour-only building or construction services'. These figures allow the business to reclaim 43% or 13% of the VAT charged respectively, assuming that VAT is being charged at the prevailing rate of 20%.

From 1st March 2021, the UK government changed the way that VAT is charged for certain kinds of construction work done by VAT-registered subcontractors, in a way that broadly corresponds to the operation of the Construction Industry Scheme (CIS) for tax and National Insurance. The CIS is an existing system where construction contractors deduct payments towards tax and National Insurance from their subcontractors' wages. Where the contractor and the subcontractor are registered for VAT and the supplies are reported within the CIS, VAT must also be remitted to HMRC by the contractor rather than the supplying subcontractor. This process is known as the 'domestic reverse charge'.

2.2 The case for change

The most tax-advantaged VAT status is zero-rating, as this imposes no additional cost on the sale or lease of the property but allows VAT on most construction costs (with the major exception of professional fees) to be recovered. When VAT was first introduced to the UK in 1973, all construction work classed as new build, alteration or extension was zero-rated while all repair and maintenance was standard-rated. However, because it proved difficult in practice to draw a firm boundary between alterations and new build on the one hand and repair and maintenance on the other, zero-rating for alterations and extensions was largely abolished in 1984, with the exception of 'approved alterations to listed buildings' that were private dwellings or used for a communal residential or charitable purpose.[10]

However, the exemption was regarded negatively by the European Commission, and HMRC classified it in early 2012 as one of a series of 'borderline anomalies' in the VAT regime that needed to be addressed. The rationale for abolishing the special regime was that 'the majority of the work covered by the relief consists of extension work which is not

9. https://www.lpoc.co.uk/help-advice/vat-information/#:~:text=Previously%2C%20the%20words%20%E2%80%9CVAT%E2%80%9D,to%20listed%20buildings%20in%20isolation.
10. House of Commons Library, *VAT on Historic Building Repairs*, Standard Note: SN01450 (July 2012).

necessary for heritage purposes', and that this generates 'a perverse incentive for change as opposed to repair'.[11]

This resulted in approximately the current basic VAT situation, where zero-rating is reserved only for the construction of new dwellings or relevant residential or charitable buildings. The broad intention of this is to encourage the construction of new dwellings while ensuring that they can be made as affordable as possible. The VAT rebate on eligible construction work for self-builders effectively aligns the tax treatment for self-built dwellings with commercial developers of residential property.

For similar reasons, various categories of work are tax advantaged through reduced rate VAT. These comprise works connected with:

- converting non-residential buildings to private dwellings;
- bringing long-term empty dwellings back into use; and
- dividing or combining existing properties.

The sale or letting of these buildings remains exempt, meaning that input VAT that has been paid cannot be recovered, but because the input VAT is levied at the reduced rate the tax is much lower than it otherwise would be.

Most other buildings (older than three years) are VAT-exempt, which reduces the tax of purchase or rental for non-VAT registered purchasers or leaseholders. However, as it is not possible to recover VAT on inputs, there is still a considerable tax requirement on works to these buildings, most of which will incur VAT at the standard rate – whether they are works of extension, alteration, refurbishment or simple repair and maintenance. However, in the case of large properties where the sale or rental market is dominated by VAT-registered clients, there is an 'option to tax' that will mean that most VAT payable on property and construction goods and services can be recovered.

It is the differential tax treatment of existing buildings and new build that has long been a focus of concern for those seeking to encourage reuse, adaptation, and retrofitting of existing buildings. At the most basic level, the claim is that charging VAT on repair and maintenance raises prices and so acts as a barrier to keeping existing buildings in good condition. In addition, the fact that domestic new build is zero-rated, while the circumstances of standard-rated commercial new build are likely to make both input and output VAT recoverable (as the construction output is in most cases a VAT-recoverable input to some other business) means that there is favourable tax treatment for new build relative to repair and refurbishment of existing buildings.

This may encourage demolition and replacement where repair and refurbishment might otherwise have been the preferred alternative. Similarly, the exempt status of existing commercial office space (unless the owner has 'opted to tax') means that inputs are not recoverable even where these are being operated as a part of a business, giving a potential incentive to demolish and rebuild where major upgrades are needed or to favour investing in new build opportunities in place of refurbishment schemes. In all these cases, the implication is that the current tax regime introduces a form of market distortion that favours new build over existing buildings.

2.2.1 Sustaining heritage

The most sustained campaigning for a reduction or removal of the differential VAT regimes for new build and repair, maintenance, alteration, and reuse has come from the heritage sector. In 1999, the Joint Committee of the Amenity Societies commissioned Jeremy Eckstein Associates to assess the impact of VAT on historic building repairs. It concluded that a reduction in rates to 5% would lead to a significant expansion in the market for historic building restoration and repair. Shortly afterwards, in December 2000, English Heritage (predecessor to Historic England) published its *Power of Place* report, which similarly called for a harmonised VAT rate of 5% on all construction work. The most immediate result was the introduction of the only currently available specific VAT relief for listed buildings. This is the grant scheme for Listed Places of Worship, where a VAT reimbursement grant scheme has been operating in some form since 2001 and is currently funded until 2025. The scheme is operated by the Department for Digital, Culture, Media & Sport (DCMS) and allows for full reimbursement of VAT on repairs, maintenance and, in some cases, renovation, for works worth £1,000 or more, excluding VAT, apart from one small claim that can be made each year of works worth £500 to £1000.

The annual budget for this scheme is currently £42 million per year, but it has proven difficult to ascertain how much of this budget is actually expended. The only widely quoted figure is that £317 million has been expended between scheme inception in

11. Quoted in https://newsblogsnew.ihbc.org.uk/?p=3974

2001 and the renewal of its funding announced in in February 2022, suggesting the average cost over that period was around £15 million per annum.[12]

In the early days, the scheme was operating on a small-scale pilot basis, so the cost is likely to be biased towards the more recent operation of the scheme. The amount actually expended appears to be securely within the defined budget, however.[13]

Following the 2000 report and the introduction of the Listed Places of Worship VAT grant scheme, Early Day Motions were put down by at least two MPs calling for more general schemes of reduced rates either on restoration work or uniform rates for all building work. Suggestions for differential reduction of VAT on works to historic buildings were nevertheless rejected by the then Labour government, a stance consistently justified by the restrictions presented by EU law, which prevented any further extension of zero-rating, and the European Commission's publicly stated concerns about differential VAT treatment for works to historic buildings.

Indeed, the Commission called for the UK's allowance of zero-rating on alterations to be discontinued, commenting that:

> "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.).[14]

Nevertheless, there was related activity from the Commission and member states in the fields of housing and labour-intensive occupations. During the UK's EU Presidency in 2005, there was an agreement to allow a special window of time during which member states could introduce reduced rate VAT on the labour input for repairs to private dwellings. The UK government did not, however, make an application to do so.

Not long after, the House of Commons Culture, Media and Sport Select Committee in its 2006 report on preserving the historic environment found that the existing VAT regime "distorts priorities, rewards neglect and works against conscientious maintenance of historic assets".[15]

The lack of response from the UK government led to an increased focus on evidence-gathering to document problems that the existing VAT regime was causing within the heritage sector and to substantiate the claims that a new tax regime could have substantive cultural, social, and economic benefits sufficient to outweigh the direct costs to the Treasury of reducing VAT.

Research from 2007 by the New Economics Foundation for the Prince's Regeneration Trust cited a number of cases where proposals to restore or renovate historic buildings (only a few which were formally designated) were subject to very high amounts of irrecoverable input VAT, in some cases sufficient to render potentially viable projects unviable. In addition, the report noted that the complexity of the VAT system – and with the it the potential for the inexpert to miss opportunities for VAT repayments – was leading charities undertaking construction works to historic buildings to seek costly professional advice on VAT optimisation. During the restoration of the De La Warr pavilion in Surrey, developing the VAT strategy cost £45,000 (consisting of £20,000-worth of internal staff time and £25,000 in

12. https://listed-places-of-worship-grant.dcms.gov.uk/about-us/
13. https://listed-places-of-worship-grant.dcms.gov.uk/about-us/#:~:text=Funding%20available&text=The%20funding%20for%20the%20scheme,for%20claims%20under%20the%20scheme.
14. European Commission memorandum MEMO/03/149, 16 July 2003, quoted in House of Commons Library, *VAT on Historic Building Repairs*, Standard Note: SN01450 (July 2012).
15. Quoted in House of Commons Library, *VAT on Historic Building Repairs*, Standard Note: SN01450 (July 2012).

professional fees to consultants) and around £40,000 during the restoration of the Oxo Tower in London.[16]

A nearly contemporaneous report from the Country Land and Business Association similarly argued that the 20% VAT rate on repairs and maintenance was putting owners off from undertaking necessary repairs to heritage buildings.[17]

In the background, such research must have had an impact on the European Commission, which had been conducting research into the effects of reduced VAT and in July 2008 proposed allowing reduced rate VAT to be charged on all housing 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."[18] Nevertheless, the EU's member states chose not to implement these recommendations.

In 2010, the Culture, Media and Sport Select Committee's 'Funding of the Arts and Heritage' report 'urge[d] the UK government to commission research into reducing the rate of VAT on historic building repairs as a means to better protect them and to act as an economic stimulus'.[19]

However, the UK government instead made moves to abolish the only remaining major form of VAT relief available to owners of listed buildings, the zero-rate on alterations to dwellings and communal residential or charitable buildings. This encouraged reuse and adaptation of historic buildings but was also criticised by HMRC (and some sector campaigners) for giving tax 'concessions only to major alterations, provoking more change to historic buildings than is necessary'.[20]

2.2.2 Stimulating the economy

The loss of the VAT concession for alterations to listed buildings focused minds in the sector again. The 'Cut the VAT Coalition' was formed, with support from the Institute of Historic Building Conservation (IHBC), the Heritage Alliance, Society for the Protection of Ancient Buildings (SPAB) and the Royal Institute of British Architects (RIBA) and construction contractor bodies such as the Federation of Master Builders (FMB). As this happened, the case for the benefits of eliminating or reducing VAT was extended to all repair and maintenance work, rather than on listed or historic buildings only, while the case for change tended to focus increasingly on the potential economic benefits of the resulting boost to demand for construction services.

The Cut the VAT Coalition's major tangible output was a 2014 Experian study that considered the effect of zero-rating labour element only of repair, maintenance, and renovation for all (not just listed or historic) domestic properties. It advocated a five-year period of reduced rate VAT on repair, maintenance, and refurbishment.

The research concluded that the direct cost to the Treasury would be £1.6 billion in the first year of a reduced VAT scheme. However, this would be in part compensated for by leading to an additional £2.1 billion of economic activity that would generate additional tax flows, reducing the net loss to the Treasury, at the end of the five-year period, to less than £1 billion. If maintained over the succeeding four years the change would be likely to lead to a total of around £15 billion in additional economic activity, further reducing the impact to the Treasury.[21] In addition, it was argued that some existing economic activity in the 'informal market' (primarily consisting of acceptance of cash-in-hand payment to evade VAT, along with the substantial DIY market) would transfer to the 'formal market', leading to increased compliance with VAT, income tax and National Insurance requirements. This would again offset the loss to the Treasury of income from standard rate VAT.

16. NEF, *Value Added: the economic, social and environmental benefits from creating incentives for the repair, maintenance, and use of historic buildings* (London: Prince's Regeneration Trust, 2007), p. 8.
17. Country Land and Business Owners Association, 'Averting Crisis in heritage, CLA report on reforming a crumbling system', CLA, 2007, quoted in
18. Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union* (2 vols, May-June 2007).) Quoted in House of Commons Library, *VAT on Historic Building Repairs*, Standard Note: SN01450 (July 2012).
19. https://publications.parliament.uk/pa/cm201011/cmselect/cmcumeds/464/46406.htm
20. NEF, *Value Added: the economic, social and environmental benefits from creating incentives for the repair, maintenance, and use of historic buildings* (London: Prince's Regeneration Trust, 2007), p. 2.
21. Experian (2014), *An estimate of the effects of a reduction in the rate of VAT on housing renovation and repair work: 2015 to 2020.*

The campaign to cut VAT has recently been renewed by the Royal Institution of Chartered Surveyors (RICS) and the FMB, using new calculations of economic benefit prepared by the CBI economics unit.[22] The calculated economic benefit of a temporary reduction on VAT on housing repair, maintenance and improvement (RMI) works is now estimated to total £51 billion over a five-year period.

With specific regard to Scotland, research conducted by the Fraser of Allander Institute of the University of Strathclyde found that stimulus to the repair and maintenance sector would have significant economic benefits. The research explored a reduction in VAT on housing repair and maintenance as a means to this. It concluded that a reduction in VAT from 20% to the 5% reduced rate would be likely to generate an additional output of between £145 million and £730 million, additional Gross Value Added of between £80 and £400 million, and additional employment of between 1500 and 3700 FTE jobs.[23]

2.2.3 Sustaining the environment

There can be little doubt that the case for reducing or eliminating the VAT requirement on works of repair and maintenance to historic buildings has largely been articulated in terms of the putative benefits for heritage and the wider economy. However, supporters of VAT reform have also made a broader case based on the environmental benefits of reuse rather than replacement of existing building stock.

These concerns have since become increasingly pressing over the last 35 years, as the Intergovernmental Panel on Climate Change (IPCC) began documenting the growing evidence for the reality and significance of anthropogenic climate change, with the link finally being stated as 'likely' in its third report in 2001. The issue became a matter of special focus for the UK government at this time. The most important and widely influential outcome of this concern was the commissioning in 2005 and publication in October of the following year of Sir Nicholas Stern's Review of *The Economics of Climate Change*. The Stern Review clearly articulated the destructive potential and high probable economic cost of allowing anthropogenic greenhouse gas (GHG) emissions to continue unchecked.

Not long after, in 2008, the UK passed the Climate Change Act. This was the world's first legally binding national commitment to a major cut in overall GHG emissions, set at 80% by 2050. It also established the Climate Change Committee to act as a national advisor and coordinator for efforts to tackle climate change. In 2015, the Paris Agreement on climate change was agreed, with the goal of limiting global temperature rise to well below 2°C, and preferably no more than 1.5°C. National targets for reducing or controlling GHG emissions were set, targeting an overall 50% reduction by 2030. Early in 2019, the Scottish and Welsh governments declared that there was a 'climate emergency', and a non-binding declaration to the same effect was passed in the UK parliament shortly afterwards. Later that same year, the UK parliament changed the 2050 target to 'net zero emissions'. The Scottish government set an even more demanding target of net zero emissions by 2045 in The Climate Change (Emissions Reduction Targets) (Scotland) Act 2019.

The National Planning Framework (NPF) in Scotland also supports government aims around the circular economy and net zero. NPF4 explicitly references 'meeting any targets relating to the reduction of emissions of greenhouse gases, within the meaning of the Climate Change (Scotland) Act 2009, contained in or set by virtue of that Act', and seeks to promote reuse rather than replacement of existing building stock.[24]

There is increasing awareness that space and water heating is one of the UK's largest sources of carbon emissions, due in large part to the widespread use of natural gas to power furnaces and hot water supplies. This has generated pressures for replacing

Zero net emissions by

2045

in Scotland

22. Federation of Master Builders and RICS, *Cut the VAT: A proposal for building back better and greener* (March 2021) https://www.fmb.org.uk/asset/351216AF-A4BD-476A-AFEA9FA46F396372/
23. Fraser of Allander Institute (2021), *The economic, social and environmental benefits of stimulating repairs and improvements to the Scottish built environment to aid a green recovery from Covid-19*, pp. 32
24. https://www.gov.scot/publications/scotland-2045-fourth-national-planning-framework-draft/

old, thermally inefficient buildings with new highly insulated ones. Countering this, however, is the recognition that the construction sector is widely recognised as a major contributor to global GHG emissions. This means that the carbon intensiveness of constructing new buildings must be set against their operational carbon benefits.

The 'embodied energy' in existing buildings and the need for whole life analysis of carbon emissions, is explored in some detail in Historic Environment Scotland's Technical Papers on *Embodied Carbon in Natural Building Stone in Scotland (2007) and Embodied Energy Considerations for Existing Buildings (2011)*. The research showed that measured over their whole lifetimes, and certainly over the next few critical decades, it is almost always more energy and carbon efficient to refurbish and retrofit them to improve their energy efficiency than to construct new buildings.

No less significantly, there is growing evidence that traditional buildings are often more thermally efficient than theoretical modelling might suggest, in large part due to the greater thermal mass of traditional masonry building construction. Finally, the large proportion of Scotland's existing building stock that is constructed from traditional materials and its cultural heritage significance, along with limited surplus capacity in the construction sector for new build, means that wholesale replacement of existing buildings is a practical impossibility. Together, the result is increasing awareness of the need to retain existing buildings, and as far as reasonably possible repair and retrofit them to improve their thermal and energy efficiency.

This potential of modifications to the VAT system to support repair and retrofit has generated particular interest in Scotland. In 2008, Nicola Sturgeon, then Deputy First Minister and Cabinet Secretary for Health and Wellbeing, expressed the view that equalisation of VAT could potentially reduce the energy and carbon cost of demolishing and replacing existing buildings. The 2013 White Paper that set out the Scottish government's case for independence prior to the 2014 referendum stated that:

> With independence Scotland will have new powers over the economy to encourage our culture and creative sectors. For example, with new powers over taxation, we can explore a VAT reduction on repairs and maintenance work.[25]

The Scottish government's stated concern to consider VAT reform on repair and maintenance contrasts notably with the reluctance of successive UK governments to extend (or even sustain previously existing) reliefs.

This has since become a wider concern, expressed notably in the Architects Journal's RetroFirst campaign. Launched in 2019, the campaign criticises the construction industry's 'wasteful economic model which often involves tearing down existing structures and buildings, disposing of the resulting material in a haphazard fashion, and rebuilding from scratch'. One of the three demands made by RetroFirst is a cut to the VAT rate on refurbishment, repair and maintenance from 20% to 5% or below.[26]

The growing concern at these issues has prompted the Chartered Institute of Building's (CIOB) Scotland branch to publish a report on '*Levelling the playing field, not Scotland's built environment'.* The report advocates reduced-rate VAT on all renovation and retrofit projects, restating the estimates of the potential economic benefits of a reduction in VAT rates of repair and maintenance produced by the Fraser of Allander Institute. It also calls for the application of a demolition levy to 'catalyse a shift in priority to favour retrofit projects, helping to re-balance the economic scales between retrofitting and rebuilding'. The revenues raised by the levy could then be used to 'fund green initiatives that support energy-efficient upgrades to housing, help low-income and vulnerable households cope with home repairs and rising fuel prices, or preserve Scotland's historic building stock'.[27]

25. https://www.gov.scot/publications/scotlands-future/pages/13/
26. https://www.architectsjournal.co.uk/news/introducing-retrofirst-a-new-aj-campaign-championing-reuse-in-the-built-environment
27. CIOB (2022), *Levelling the playing field, not Scotland's built environment*

Angus Robertson MSP, the Scottish Government's Cabinet Secretary for the Constitution, External Affairs and Culture, has also signalled the Scottish government's sympathy for reform of VAT culture sector. In a letter to Lucy Frazer MP, following her appointment as Secretary of State for Culture, Media and Sport in February 2023, he wrote that owners of traditional buildings in Scotland face 'significant costs in meeting the efficiency targets and listed buildings or scheduled monuments face different challenges in installing energy efficiency measures, which can be more costly than those faced in more modern properties', and that consequently 'the removal of VAT on these repairs or retrofitting would be most welcome'.

2.2.4 Sustaining skills

Most arguments in favour of reducing or eliminating VAT on construction repair and maintenance have been made in terms of potential benefits to heritage, the economy, and the environment. A final additional argument is that there could be benefits for skills development. This would be especially beneficial given the long-term problem with skills supply in the construction industry, especially in traditional building craft skills of the kind most important for repairing and maintaining traditional and historic buildings.

The supply of heritage building skills was the subject of a series of major research reports by the National Heritage Training Group (NHTG). The first was an overview report in 2003, followed by more detailed research on the situation in England (2005), Scotland (2007) and Wales (2007), complementary research on professional skills (2008), and an update to the England report (2008). There was subsequently a full reassessment of the situation in England and Scotland (2012). All these reports identified significant shortages of fundamental skills for the repair, maintenance and renovation of traditional buildings. Shortages were less acute in 2012, when construction activity in the UK remained subdued after the 2008 financial crisis, but still remained substantial. Moreover, the associated decline in workflow and reduction in prices resulted in significant consequential impacts recruitment and on investment in training.

Although there has not been significant detailed research on the supply and demand for heritage-related construction skills since 2012, there are well-documented skills shortages and gaps in the wider construction industry. These have become more acute as the construction sector has recovered since the slow-down in the early 2010s and, especially, since Brexit reduced inflows of labour from the EU.

According to the RICS and FMB's most recent 'Cut the VAT' report, the combination of a skills shortage and boost to demand would lead to increased training and upskilling in the sector:

> "The construction industry has historically suffered from a skills shortage across a broad range of skill levels from bricklayers to surveyors, meaning it has the capacity to absorb young new entrants and people looking to change careers. Cutting VAT on home improvement works for the next 5 years would unlock 344,721 additional jobs in construction and the wider economy.

In a similar vein, the CIOB's report on the potential benefits of a VAT reduction in Scotland states that:

> "Retrofit works are labour intensive and grounded within local supply chains; these are ideal projects to maximise employment within the sector, support regional growth and provide opportunities for training and re-training in low-carbon construction skills.[28]

The underlying assumption is that a stimulus to demand will lead the sector to invest in skills development and training to enable it to meet that demand. In addition, it is likely that at least some of the additional stimulus would lead to increased prices and wages. Although the potential inflationary effects are not in themselves desirable, such a movement could serve to incentivise recruitment into the sector while de-risking investment in skills development and training.

28. CIOB, *Levelling the playing field, not Scotland's built environment*

2.2.5 'Levelling the Playing Field'

The common denominator of the arguments for reducing VAT rates on repair, maintenance, refurbishment and retrofit is concern that the current differential VAT regime distorts the market in a way that serves to disincentivise keeping existing buildings in good order and to incentivise their replacement by new build structures. The VAT system therefore causes a form of 'market distortion' that results in socially, culturally, economically and environmentally suboptimal outcomes that campaigners wish to see addressed through uniform (or at least more uniform) VAT rates for new build and works to existing buildings.

The market distortion is, arguably, an intentional policy result. In a country where there has been, for a considerable time, major undersupply of housing in particular and in which new construction is a major sector of the economy, the application of a reduced or zero-rate for new construction can be regarded as an attempt to direct resources towards new build in order to encourage increased supply and so promote these public benefits.

Nevertheless, there does not seem to have been much research to establish whether zero-rating for new build actually has this stimulus (or any other publicly beneficial) effect. Given the general principle that intervening in the free market should be considered only where there is evidence of market failure, the unexamined continuation of a legacy tax regime for new build would seem to be problematic. This is especially the case given that a number of prima facie arguments can be advanced that the implicit subsidy is not, at least in the UK context, especially likely to have the desired beneficial outcomes. Given that the baseline inadequacy of housing supply in the UK means that housing tends to be priced up to the capacity of the market to pay, there is an argument to be made that zero-rating is likely to have resulted primarily in increased prices for undeveloped land rather than increased supply or reduced consumer prices for a given level of housing quality.[29]

Given that there is fair evidence that VAT on repairs and maintenance does have the effect of reducing demand due decreased affordability, we may be looking at a situation where there is an implicit subsidy for one part of the economy that is having few practical benefits, while lack of comparable treatment in a closely related part of the economy is causing documented negative consequences.

The argument for 'levelling the playing field' has relevance in relation to labour intensive sectors versus the rest of the economy. There is an argument to be made that in sectors of the economy where labour forms the primary component of the cost, there is less capacity to pay a sales tax than where production technologies have led to economies in production. There is some theoretical and empirical evidence that high 'tax wedges' (high marginal income tax and high sales tax rates) disincentivise demand for (legitimate) labour intensive services and promote labour substitution through DIY or the development of tax avoidant 'black market' services.[30] There is an argument to be made that the high tax payable in contemporary industrialised societies reflect the exceptional efficiency of modern technologized forms of production, which creates a large surplus that can be in part absorbed by central government and repurposed to wider social benefit.[31] Where such efficiencies remain relatively limited, as in many labour-intensive services, they will be greater and potentially serve to disincentivise socially desirable consumption, depress wages, and ultimately reduce the supply of skills. As the supply of building repair and maintenance services tends to be highly labour-intensive, these issues are likely to be especially relevant.

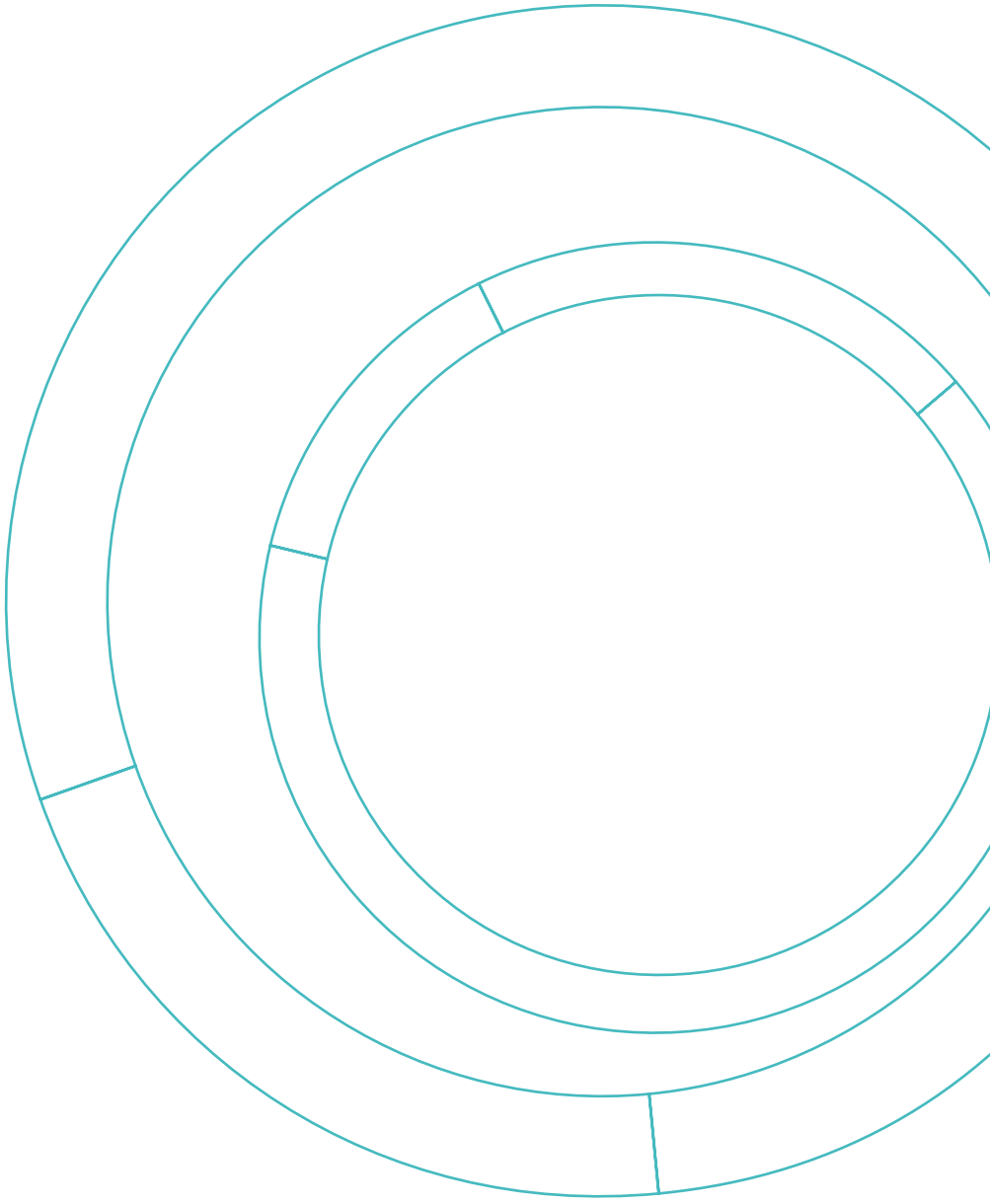
These potential issues are, moreover, arguably even more significant in the context of listed buildings than traditional buildings more generally. Listed buildings often require even more highly specialised materials and labour for their repair and refurbishment, both through their intrinsic physical nature and the

29. This relates directly to the longstanding controversy over developers 'land banking', i.e. purchasing land and then failing to develop it to take advantage of rising prices. Successive Local Government Association reports have stated that this happens on a considerable scale but other research has found slowness in converting land acquisitions to housing supply primarily reflects delays in the planning system, and the Lyons Review (2014) found little direct evidence to substantiate claims of intentional restriction of supply, at least outside London, but also an inadequate research base on the subject. https://www.yourbritain.org.uk/uploads/editor/files/The_Lyons_Housing_Review_2.pdf

30. Copenhagen Economics, S*tudy on reduced VAT applied to goods and services in the Member States of the European Union* (2 vols, May-June 2007).) Quoted in House of Commons Library, *VAT on Historic Building Repairs,* Standard Note: SN01450 (July 2012).

31. Gerhard Lensky, *Power and Privilege* (1967) *and Ecological Evolutionary Theory: Principles and Applications* (2005)

requirements imposed by the statutory heritage protection regime. In the past, there were relatively generous grants and subsidy schemes from both the heritage agencies and many local authorities for repair and refurbishment of listed buildings. Growing funding constraints have gradually reduced the amount of grant aid available, especially for private and commercial owners. The discontinuation of Historic Scotland's Historic Environment Repair Grant programme means that there is no longer a formal national grant programme that prioritises repairs to listed buildings. The replacement Historic Environment Grant (HEG) scheme has broad scope and prioritises 'suitably experienced not-for-profit organisations'.[32] The result is that owners of listed buildings – especially private and commercial owners – must cover the additional costs that come with owning a listed building primarily from their own resources. In these circumstances, zero-rating or reduced rating of VAT on listed building repairs could readily be seen as a reasonable relief to those additional costs.



32. https://www.historicenvironment.scot/grants-and-funding/our-grants/historic-environment-grants-programme/#programme-criteria_tab

Approaches used to reduce the VAT requirement and understanding how potential impacts may be realised

3. Approaches used to reduce the VAT requirement and understanding how potential impacts may be realised

3.1 Approaches to reducing the VAT requirement

There are multiple potential ways of reducing the VAT on the repair, maintenance and retrofit of historic buildings. These can broadly be divided into approaches that entail changes to the rates or administration of VAT and those that leave the current VAT system unchanged but allow some form of rebate or grant to be claimed that is equivalent to the VAT paid to HMRC.

The approaches that would require change to the VAT system itself are primarily:

- Introducing reduced rate or zero-rate VAT on works of repair and maintenance (and potentially alteration and extension) carried out on listed buildings.
- Reducing VAT on domestic repair and maintenance work to the 5% reduced rate, an approach that initially attracted attention because it was readily compatible with EU VAT law.
- Introducing a total or partial VAT rebate or reclaim process for customers/end users, similar to that currently available to self-builders.

The majority of research into VAT and construction has considered the first two of these three systemic changes. However, none of these approaches could readily be introduced only in Scotland. The VAT regime does not lie within the devolved powers of the Scottish government and there are few indications as yet that the UK government is minded to reconsider its stance on VAT on repair and maintenance. This means that some form of VAT-rebate or reclaim scheme is likely to be the only practicable way of proceeding, at least in the short- to medium-term.

There are two basic options for such a rebate or grant scheme:

- Introducing a VAT grant scheme similar to the Listed Places of Worship scheme but available for a wider range of beneficiaries.
- Introducing a mechanism whereby construction contractors would not charge VAT to clients for eligible works but would themselves receive a payment that would cover their VAT liabilities to HMRC.

The advantage of the rebate or grant approaches is that it can be much more precisely targeted than a system-wide change to prevailing VAT rates on repair and maintenance. The corresponding limitation, however, is that it would do less to 'level the playing field' between new build and existing properties.

3.2 Understanding potential impacts

The longstanding campaign for changes to the VAT regime to remove the tax penalty on existing buildings relative to new build has built a persuasive case that if this policy was implemented it would have substantial benefits for heritage, the economy, environmental sustainability and – to a lesser extent – skills supply. The modelling that has been commissioned in this context has consistently identified economic benefits that would help counterbalance, though not entirely eliminate, the cost to the Treasury in reduced VAT revenue.

However, it is not always clear how robust these claims of benefit are. A substantial body of literature was produced in 2003 in connection with the EU's experimental reduced-rate VAT programme for labour intensive occupations. There has been some evidence of positive economic stimulus from the introduction of reduced rate VAT for domestic construction work in the Isle of Man. A questionnaire sent to VAT-registered construction contractors found that 96% reported both passing on the price saving to consumers and to seeing a consequential increase in work. A considerable proportion (40%) also reported that it had encouraged consumers to have work done and a smaller proportion (20%) felt that it had reduced consumer use of black-market providers. No respondents reported taking on more staff. The robustness of these results is questionable as the questionnaire was sent to only 15% of contractors (on an island where the total economically active population at the time was fewer than 40,000) and the response rate was only 56%. The absolute sample size is also unknown, making it even more difficult

to estimate how representative the findings are likely to have been. Partly as a result of these limitations, the EU research treated the reported benefits from the Isle of Man scheme with some caution. Nor, in the case of the Isle of Man, has it proved possible to identify research that seeks to estimate whether the reduced-rate VAT scheme actually led to improved outcomes in terms of the physical condition of buildings.

Moreover, the overall conclusion drawn by the European Commission from the studies of such schemes was that many of their anticipated benefits were not realised. In particular, there was little substantive evidence of the VAT reduction being passed on to consumers as reduced prices, with most VAT saved instead being taken in the form of increased wages for service suppliers.[33]

Subsequent EU research on a large number of VAT-reduction initiatives found that the average pass-through rate for the cuts was around 32% (though this finding had a low level of certainty).[34]

Where cuts are used to boost income this would, of course, lead to some downstream effects in the form of increased income, and potentially expenditure, by those working in the sector, but in the general economy rather than in the target sector.

More generally, an important limitation of the studies produced by advocates of VAT reduction is that they are not, in general, comparative – that is to say they do not consider the likely impacts of changes to VAT in relation to other policy options with similar or lesser net costs to the public purse. This means that it is not clear from them whether VAT reduction represents the optimal policy choice to realise the claimed heritage, environmental, economic and skills benefits. This means that, however impressive the figures cited might seem to be, they may represent a suboptimal choice when compared to other policy options such as directly targeted grants or subsidies.

This is especially important because the reduction in government income, if accompanied by reductions in government expenditure elsewhere in the economy, will have a negative impact on the level of economic activity in the sectors from which government spending is withdrawn. In this connection it is worth noting that even the recent Fraser of Allander Institute analysis found that the positive benefits of the 'demand shock' resulting from a VAT cut for repair and maintenance would not counterbalance the negative effects of reduced government expenditure. This means that net short-term economic benefits would accrue only if the initiative were to be debt-financed. Debt-financing entails long-term cost in debt service. The study did not attempt to quantify the smaller annual, possibly because such longer-term implications are intrinsically difficult to model; but potentially larger cumulative, economic impacts of reduced government spending due to higher government debt should certainly be borne in mind.

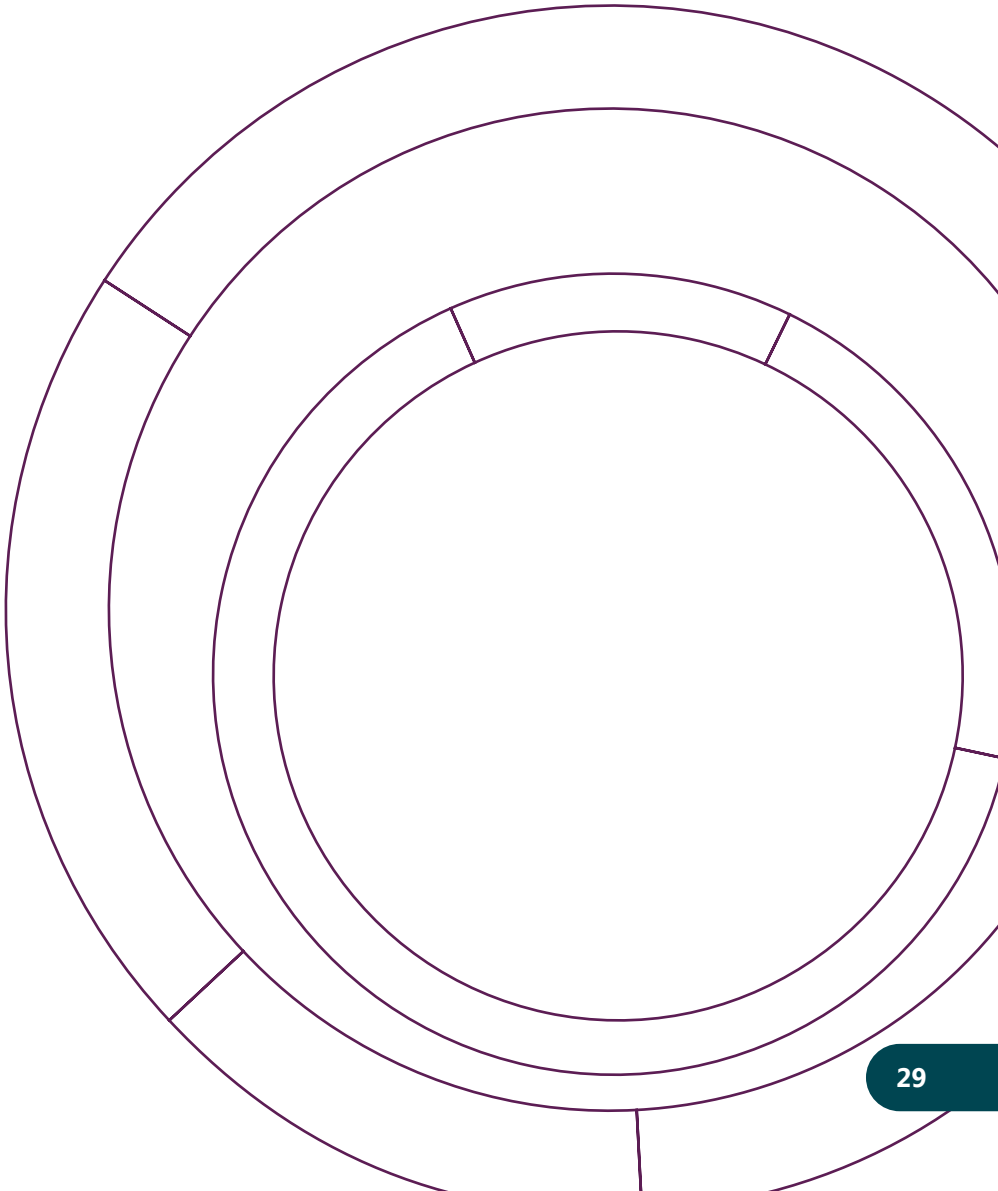
These studies have another major limitation of in the context of Historic Environment Scotland's primary policy concern with the preservation and sustainability of Scotland's heritage. Few of the recent studies deal with the costs and benefits of a modification of VAT specifically in respect of historic or listed buildings. It is striking that while sustaining built heritage was the most important initial driver for the campaign to cut VAT on repair, maintenance, refurbishment, and alteration of existing buildings, almost all recent studies have broadened their focus to all existing, or all existing domestic, buildings. There is therefore very little information specifically on the potential impacts of VAT reductions on listed buildings.

Moreover, no specifically Scottish research or data of this kind have been identified in the course of the present study.

More generally, outside of the built environment sector, there is some evidence to suggest a VAT cut is effective in stimulating consumer demand, but this is reliant on having the 'right' conditions in place – notably a strong supply chain able to cope with increased demand, and a broadly favourable economic climate. A temporary VAT cut in the UK between 2008 and 2009 boosted retail sales.[35] However, the impact appears to be greater if a VAT cut is temporary – creating the incentive to spend while there is a lower rate in place (or scheme in place to claim VAT back). Furthermore, once VAT rates return to previous levels, prices could be even higher than prior to the cut/rebate.[36]

33. European Commission (2003), *Evaluation report on the experimental application of a reduced rate of VAT to certain labour-intensive services*; EU Commission (2003) *Experimental application of a reduced rate of VAT to certain labour-intensive services*.
34. With a confidence level of 95%, the confidence interval was up to as much as 50%.
35. Crossley, T.F., Low, H.W., & Sleeman, C. (2014) *Using a temporary indirect tax cut as a fiscal stimulus: evidence from the UK*. IFS Working Paper W14/16. Institute for Fiscal Studies.
36. *'What goes up may not come down: asymmetric incidence of Value-Added Taxes'*, Journal of Political Economy

In addition, if a blanket strategy of VAT cuts or rebates is introduced for works on all listed buildings in the hope of meeting specific policy goals, it is difficult to be assured that it will promote those goals without substantial 'deadweight'. In some cases, for example, it will act as an implicit subsidy for works that would have taken place regardless. It may stimulate demand from clients in little need of subsidy, while not being sufficient to support those in most need to undertake works to their buildings. It may restore balance between new build and renovation, retrofit and repair, but the associated removal of the market distortion that results from differential tax treatment may not be sufficient to promote the socially beneficial outcomes sought by government. Anecdotal evidence from built environment professionals suggests that private building owners tend to prioritise expenditure on internal upgrades such as kitchens and bathrooms over fundamental repair and maintenance. If this is the case, it is doubtful whether changes to the VAT regime will be sufficient to direct consumer behaviour towards increased basic repair and maintenance rather than cosmetic improvements.



Calculating values of a VAT rebate scheme

4. Calculating values of a VAT rebate scheme

4.1 Supply and demand-based modelling

Methodologies used in previous research include Historic England's 2012 report: The Economic Impact of Maintaining and Repairing Historic Buildings in England.[37] This used a 'top down' method to estimate Repair and Maintenance (R&M) expenditure (estimating proportion of total R&M spend generated by pre-1919 buildings).

English Heritage, Historic England and the CITB's jointly commissioned a 2013 report – Repair, Maintenance and Energy Efficiency Retrofit of Traditional (pre-1919) Buildings in England and Scotland.[38] This used a different methodology, in that it asked contractors about the proportion of work they carry out on traditional buildings and applied this proportion to total industry turnover. These two reports produced widely disparate figures.

For this research it was decided that the most robust results will result from an approach of:

1. Using both supply-based approaches above and working iteratively to refine and identify errors/flawed assumptions, until they both produce results that are convergent to an acceptable degree.
2. Cross-referencing this with demand-based analysis.

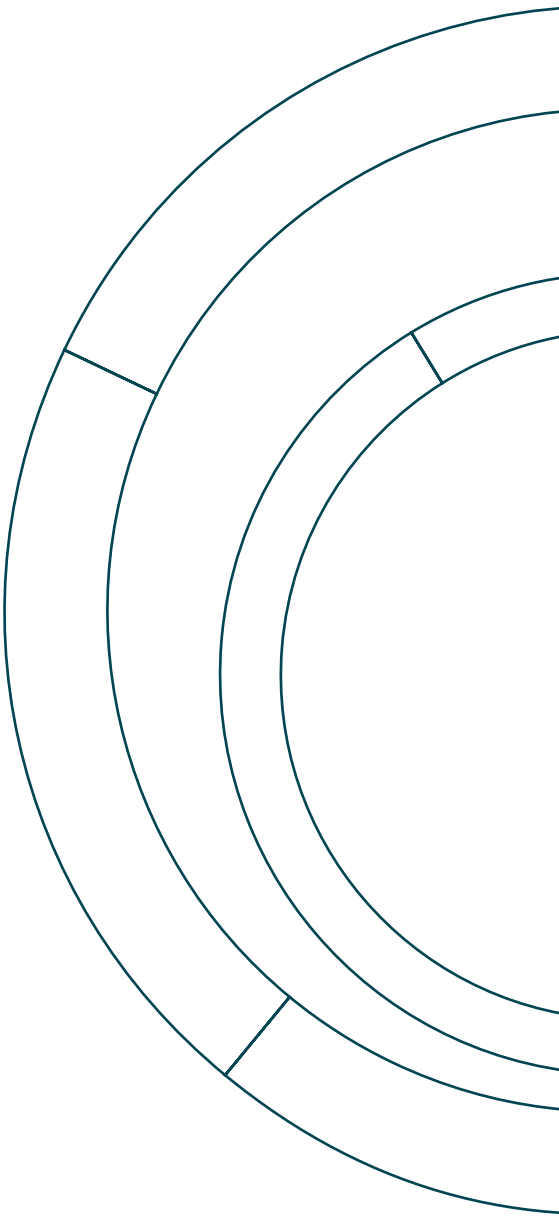
Demand based analysis involved calculating the value of all works which received Listed Building Consent in 2022, by extrapolating from the sample valued by a specialist heritage Quantity Surveyor.

4.2 Types of changes made to listed buildings each year

Advanced searches on all 32 Scottish Planning Authorities' portals found 2568 decided, granted, and approved Listed Building Consent applications for 2022. Searches on the descriptions of these are summarised in Figure 1 below. The majority of applications can be listed under seven categories: Windows, Roofs, Extensions, Doors, Walls Signs and Demolition. These categories are mentioned a total of 2091 times in 1481 of the 2568 applications.

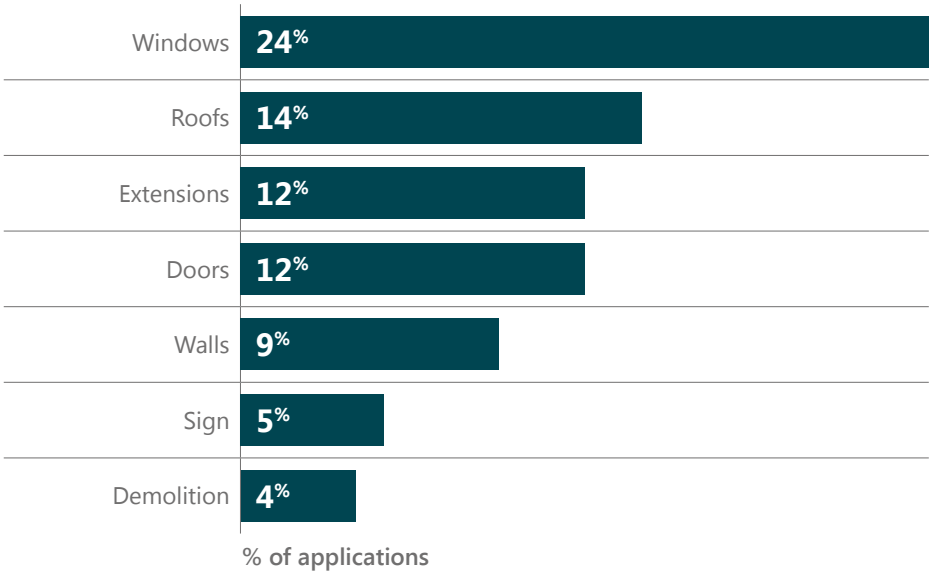
Categories of improvement receiving just a few mentions include: work on chimneys and flues, railings, bollards, handrails, fences and installation of CCTV.

Searches on energy saving alterations, showed Solar mentioned in just over 1% of applications, Heat pumps in 1.4% and Insulation in 0.2%.



37. Historic England: The Economic Impact of Maintaining and Repairing Historic Buildings in England 2012
38. English Heritage, Historic England, CITB Repair, Maintenance and Energy Efficiency Retrofit of Traditional Buildings in England and Scotland. 2013

Figure 1: Listed Building Consent main categories of planning applications



4.3 Cumulative value of Extension, Repair and Maintenance (ERM) work carried out on listed buildings each year

Three models were used to estimate the value of ERM work. Appendix 1 contains a detailed explanation of the models.

The models are:

1 Top-down supply model

This uses a 'top down' method to estimate ERM expenditure i.e., estimating the value of total ERM expenditure which can be attributed to listed buildings. The proportion is estimated by comparing the ratio of areas of listed buildings and non-listed buildings.

2 Bottom-up supply model

This model estimates the proportion of work by value contractors carry out on listed buildings and applies this proportion to total ERM turnover.

3 Demand model

This model estimates the value of works required for all Listed Building Consent granted over a 12-month period. The methodology involved extrapolating from a sample of applications valued by a specialist Quantity Surveyor.

There are intrinsic uncertainties, primarily due to the lack of specific data to inform modelling. The final estimate of the value of ERM work for listed buildings in Scotland is derived from considering the two supply models, refining these, and identifying errors or flawed assumptions, until they both produce results that are convergent, then cross-refencing with demand estimates.

The equations, parameters and methodology for each model are included in the annex, this enables modelling to be refined in terms of both the equations themselves and the data inputs, in the light of improved understanding and source data.

Expenditure on non-domestic extensions is not included in the Office for National Statistics (ONS) data on which the two supply models are based. The outputs from these models are termed Repair and Maintenance (RM) expenditure.

Non-domestic Extension expenditure is calculated separately, by analysis of demand data derived from Listed Building Consent applications.

Estimates of total Extension Repair and Maintenance (ERM) expenditure are derived by adding non-domestic extension expenditure to the supply model outputs.

The estimated value of annual Extension Repair and Maintenance work for Scottish listed property is £377m.

This figure is the central point on a range derived by analysing the point at which the two supply models converge, and a calculation of non-domestic extension work derived from demand analysis of Listed Building Consent applications.

Outputs from the top-down supply model are summarised for a range of values of W (the cost differential ratio for work on listed buildings) in Table 1.

Table 2 shows the outputs from the bottom-up supply model for a range of ratios of contractors' ERM work carried out on listed buildings to their total ERM work.

These two outputs converge at £290m. This is necessarily an approximation derived using available data, as more robust data becomes available the models can be used to refine the estimate.

To this figure must be added the value of non-domestic extensions and the value of work carried out in the black economy.

The point of convergence is where the cost differential for work on listed buildings is 10% and the proportion of contractors' work by value carried out on listed buildings is 7%.

There are no data sources for the value of non-domestic extensions to listed or non-listed property. A value for this figure was derived from analysis of Listed Building Consent applications; by taking the total of applications for extension work and calculating the proportion of these which are non-domestic. This calculation is shown in Appendix 1.

The estimated value for non-domestic extension work to listed property is £87m.

The estimated total value of ERM works on listed property is £290m + the value of non-domestic extension work, giving a total of £377m.

The estimated range of total value of ERM work on listed property is between £352m and £401m.

This excludes the value of works in the black economy.

Table 1: Top-down supply model value of ERM* works on listed property

W	Listed residential value	Listed non-residential value	Total £m
0.1	97	168	265
1.1	106	184	290
1.2	114	200	314
1.5	141	246	387

Table 2: Bottom-up supply model value of ERM* works on listed property

WI/Wt	Listed residential + Listed non-residential £m
10%	414
8%	331
7%	290
6%	249
5%	207
4%	166

Table 3: Demand model of works requiring Listed Building Consent

Average of sampled valuations	£117,177
Scaled-up total value of works for which LBC has been granted	£301m

*Both tables above exclude non-domestic extensions and the black economy

4.4 Proportion of cost represented by VAT

The estimate of Scottish Listed Building ERM at £377m is calculated excluding VAT; estimation of the VAT due on this amount is complicated by the various VAT schemes applying to construction and the lack of data covering in what proportions these are used by the industry.

HMRC operates simplified VAT schemes for smaller building contractors. These essentially divide the sector into predominantly labour and labour + materials contractors – with the largely labour contractors paying the equivalent of 87% of full VAT and the labour + materials contractors the equivalent of 57% – so effectively VAT rates of 17.4% and 11.4% respectively. There are no robust data for the proportions of construction output accounted for by each of these schemes.

The methodology for estimating the VAT proportion involves taking the two schemes above as proxies for the amount of VAT levied on the construction sector, and estimating of the proportion of the value of works on listed buildings which falls into each of the schemes – labour-based services and labour + materials services and applying the HMRC rates for each segment.

An estimate was derived by assuming that those providing labour-based services are likely to be smaller contractors. The proportion of firms with fewer than five employees was taken to represent this segment; with the remainder of the industry assumed to be labour + materials contractors.

Table 4 shows the proportion of specialised construction activity by number of employees. Specialised construction covers most construction trades and excludes civil engineering which is less relevant to ERM.

Table 5 shows the calculation of the estimate of total VAT payable Scottish listed building ERM expenditure.

The VAT due on listed building ERM of £377m is estimated at £47m. The total VAT inclusive amount paid for construction ERM work is £424m. The proportion of cost represented by VAT is 11%.

Table 4: Construction output by size of firm[39]

Size of firm (by number employed)	Specialised construction activities (other than scaffold erection n.e.c.)	
0 - 4	2,019	22%
5 - 9	1,228	13%
10 - 19	1,058	11%
20 - 99	2,760	30%
100 + or >£60m turnover	2,171	24%
All firms	9,236	

Table 5: Calculation of total cost represented by VAT

Demand of £377m	Labour contractors	Labour and materials contractors
	22%	78%
Applicable ERM	£82.41	£294.59
VAT rate	17.40%	11.40%
VAT amount	£14.34	£33.58
Total VAT	**£47m**	

£47m

ESTIMATED VAT DUE ON LISTED BUILDING ERM OF £377M

39. ONS Construction annual tables 2022

4.5 The direct cost of a VAT rebate

The estimated direct cost of a VAT rebate is £47m. The net cost would be less than this because of the stimulus to the economy and the effect on the black economy. The extent of the stimulus to the economy involves consideration of the elasticity of demand for ERM work on listed buildings and the amount of the rebate which contractors would pass on to clients.

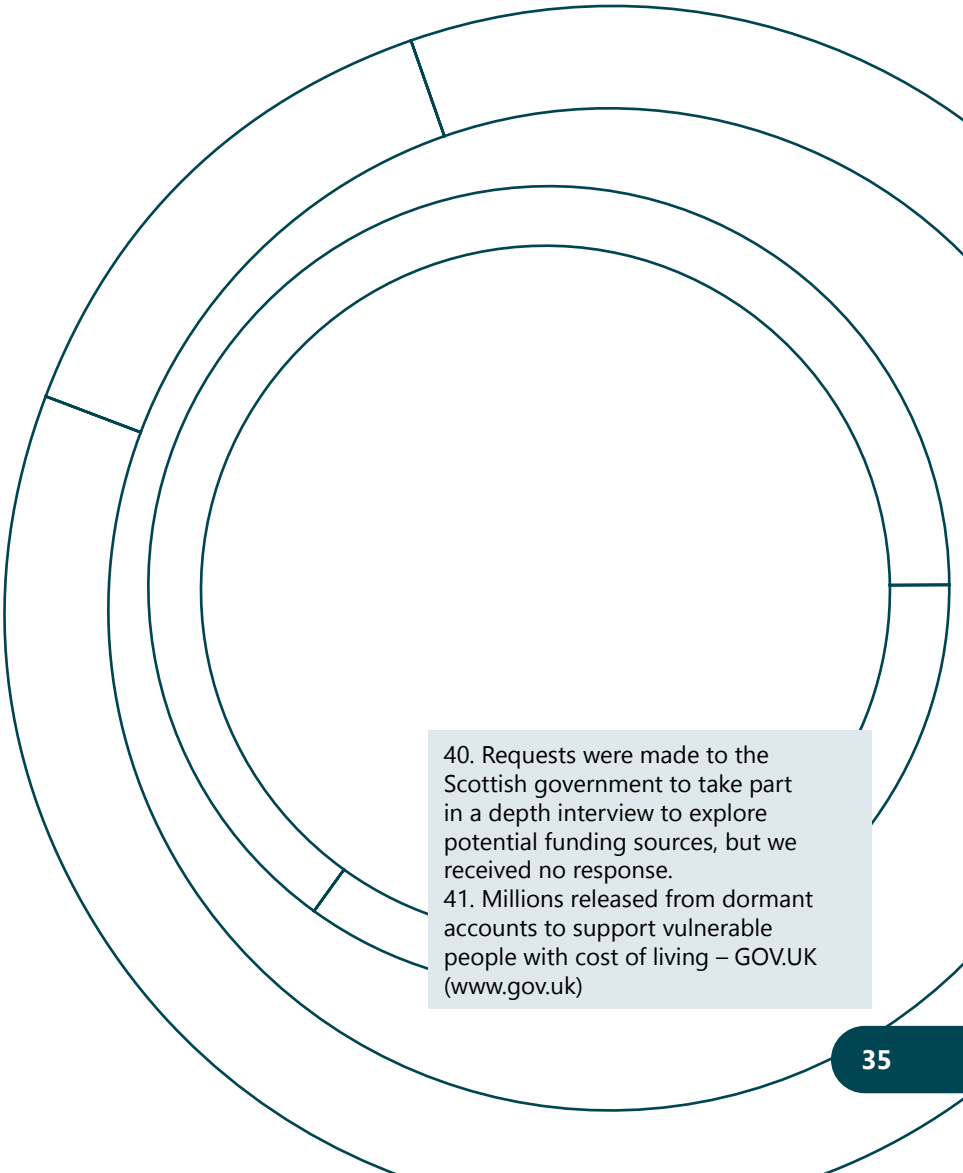
Depth interviews and survey data indicate that following a VAT rebate there may be a tendency for owners of listed property to increase their spend on ERM, which would effectively increase the value of construction ERM commissioned.

There are no robust data covering elasticities of demand in for construction ERM. Depth interviews and survey data suggests there would be a tendency for listed property owners' ERM expenditure to stay the same, but as this would be excluding VAT, it would effectively be an increase in demand of £47m. Desk research, stakeholder interviews and survey data indicate contractors may retain some of the rebate, and that clients are unlikely to increase their spend by more than the rebate.

Any consideration of increased demand assumes there is spare capacity in the supply chain. Other considerations are the effect that a rebate would have on the black economy i.e., would contractors currently operating in the black economy shift at least a proportion of their work into the formal economy?

These two factors – a £47m increase in demand and black economy activity transferring into the formal activity would increase tax receipts and lessen the direct cost of a rebate.

It is not clear how VAT cuts/ rebates are funded at government level.[40] This may differ depending on the economic climate, policy direction of travel and potentially a number of other factors that are unknown to us. It may be possible to assess other possible sources of funding which *could* be used to fund a VAT rebate, but this would be speculation. One such example is the Dormant Asset Scheme, launched in March 2023 to support vulnerable people with the cost-of-living crisis by using money from accounts left dormant for many years.[41]



40. Requests were made to the Scottish government to take part in a depth interview to explore potential funding sources, but we received no response.
41. Millions released from dormant accounts to support vulnerable people with cost of living – GOV.UK (www.gov.uk)

The potential impacts of a VAT rebate

5. The potential impacts of a VAT rebate

This research has explored a range of potential impacts which could arise from a VAT rebate scheme; evidence also pointed to other considerations that will need to be taken into account. This chapter explains the key findings.

It is important to note that these are all *potential* impacts. There are no guarantees that changes would actually transpire; furthermore, the right conditions must be in place to engineer and maximise any impacts.

5.1 Repair and maintenance of listed buildings in Scotland

Interview and survey evidence indicate a VAT rebate scheme would be an effective stimulus for higher volumes – or better quality[42] – repair and maintenance work, enabling homeowners to maintain their listed buildings.

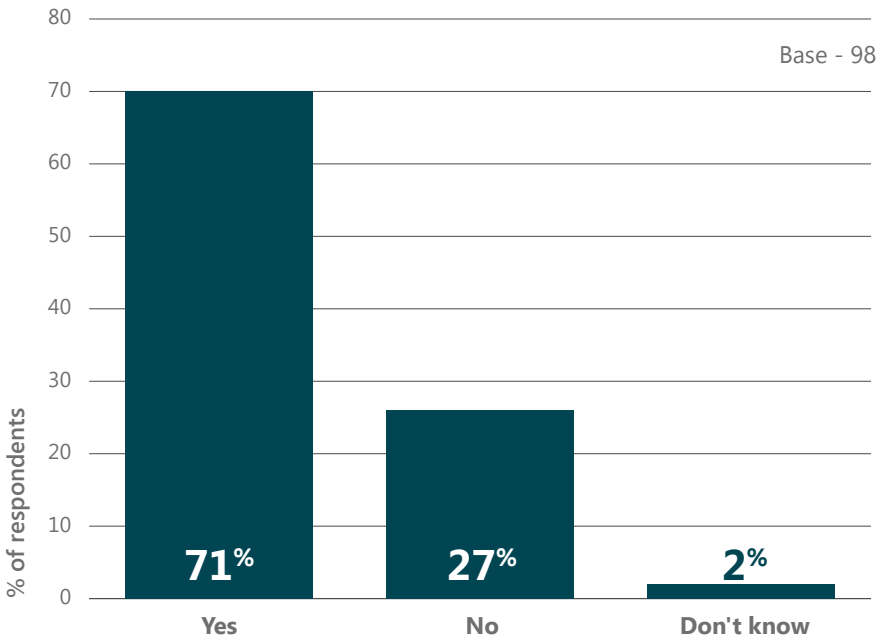
Our survey of listed property owners in Scotland undertaken for this research, found over 70% of respondents had delayed repair and maintenance work because of lack of funds (Figure 2).

Evidence obtained from industry stakeholders suggests there is a large volume of essential repairs which would be stimulated through a VAT rebate scheme.[43] Owners of listed buildings point to an "imbalance", due to the nature of the work that needs to be commissioned and its cost.

> A VAT rebate would go some way to addressing the imbalance faced by owners of listed buildings. At the moment the owners of listed property have an awful lot of constraints on the work they can do, and they incur extra costs, but they receive nothing in return from the government. There is effectively a penalty for owning a listed building.

> To a great extent because by their nature listed properties will be more expensive to repair and maintain. Costs are higher, for example for simple pointing/flashing. Energy performance is difficult and expensive to improve. Taking windows as an example, owners of listed property can rarely use an off the shelf product there is usually a need to recreate an existing pattern, so these always have to be bespoke.

Figure 2: Are there any maintenance or repairs you would like to undertake but are currently delaying due to lack of funds?



42. Quality can be undermined by scarcity of skilled and experienced tradespeople available to work on listed buildings – discussed in more detail in section 5.3.1.
43. The majority of stakeholders also pointed out that a VAT rebate is not the sole solution, and that there is a desire for VAT reform more generally, to act as a further stimulus and/or accelerate change.

Respondents also note the extent of disrepair among listed housing stock in particular, requiring fabric-first remedial works; it was emphasised that for a VAT rebate scheme to be effective, the *right* kinds of remedial activities must be undertaken. Concerns were expressed about the risks of sub-standard work – predominantly because of scarcity of skilled labour, and also because of a lack of awareness and understanding among listed property owners, of the types of work that should be undertaken, materials that should (and should not) be used, and how this should be implemented (discussed in more detail in chapter 7).

Survey data indicates a VAT rebate scheme would have an impact on reducing the repair and maintenance backlog; 40% of respondents say they would not have any outstanding repairs or maintenance had VAT not been chargeable (Figure 3). Furthermore, 98% of respondents say if VAT was not charged on repair and maintenance in the future, this would clear their backlog either fully or to some extent. Over half of the survey respondents say this would fully clear their repair and maintenance backlog (Figure 3).

Several stakeholders pointed to the Conservation and Regeneration Schemes (CARS) as an example, illustrating the availability of additional funds acted as a stimulus to undertake repair and maintenance work.

Figure 3: If VAT had never been chargeable on repair and maintenance, do you feel you would still have outstanding maintenance or repairs?

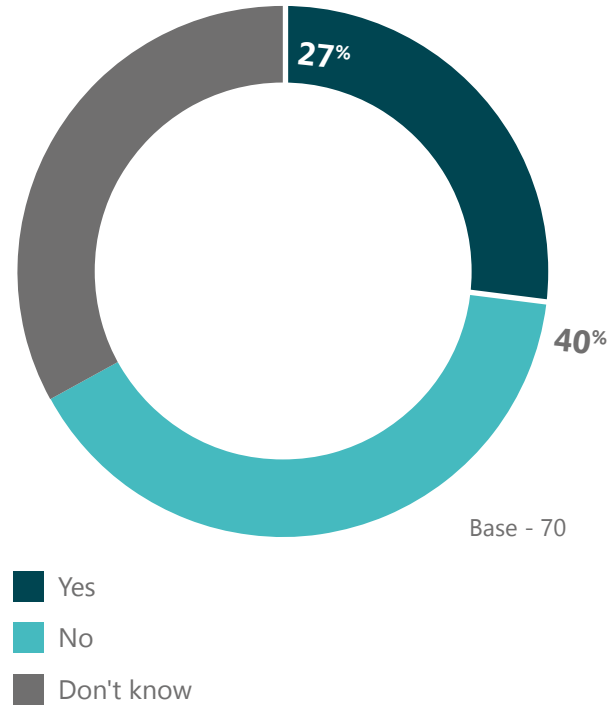
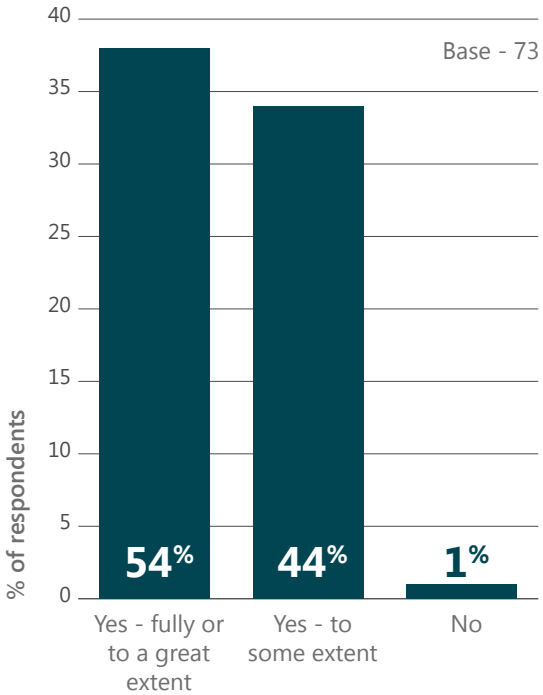


Figure 4: If in the future VAT was not charged on maintenance or repairs would this help you to clear your backlog?



> Yes [a VAT rebate scheme] would help to clear the [repair and maintenance] backlog… this is well illustrated in the Conservation and Regeneration schemes (CARS) in Scotland. These are towns that received money from Historic Environment Scotland to fund repair and maintenance work on traditional buildings. What this scheme shows is that, given the correct circumstances – i.e., if there is money available to fund the work – then the repair and maintenance work rolls on.

However, as stated above and explained further in section 5.3.1, the extent to which a stimulus would result in increased repair and maintenance work will be severely constrained by an acute shortage of skilled labour.

> It would increase the appetite to want to do more work. Whether this could happen in practice is another question – because of the major skills shortages in traditional building. This is an acute issue.

Affordability also must be taken into consideration. Costs may be higher for work on listed buildings; evidence from interviews with owners of listed properties believe there is a price premium in the region of 20%. The economic climate will influence the amount of work that is commissioned, even with the stimulus of a VAT rebate scheme (discussed more in section 5.5.3).

Awareness of such a scheme would also be a crucial element of maximising the impact, i.e., more repair and maintenance work undertaken on listed buildings (discussed in section 5.5.2).

5.2 Preservation and regeneration of traditional and listed buildings in Scotland

Evidence gathered from listed property owners and industry stakeholders suggests a VAT rebate scheme would be expected to contribute towards preservation of the character of traditional buildings – predominantly because of a greater likelihood of using the correct materials, as more funds would be available with which to undertake the work.

> The 20% reduction in cost would essentially expand the budget, which would mean more work could be done for the same budget. Undoubtedly it would have an impact. Preservation of our heritage is incredibly important.

> Sometimes work is carried out but… cheaper materials are used, these may be durable but are sometimes less aesthetically pleasing.

> Price is a big factor, if owners were helped with VAT if there are windows which need replacing, they might be less tempted to go for UPVC rather than wood.

Respondents are also positive about the potential impacts for regeneration of listed buildings in Scotland; concerns were expressed about the **high likelihood of listed buildings falling into disrepair after lack of use**, including properties on the high streets such as former department stores and former banks, as well as churches. This in turn increases the likelihood of demolition rather than repair – particularly in the context of high cost, low availability skilled labour and traditional materials. Climate change, and heavy rainfall as a result of this in particular, is a factor in acceleration of disrepair, as well as more clearly revealing weaknesses in building fabric.

Lack of money for regeneration is only one aspect; developers and funders make choices which can favour demolition over regeneration – for example for ease and speed.

The combination of these factors is a barrier to regeneration of listed buildings; however, freeing up funds via a VAT rebate scheme is not necessarily a route to making regeneration a more accessible prospect. Buildings which have fallen into disrepair through lack of use are already subject to a 5% VAT rate. There is the potential for benefits to be realised but it is unlikely to result in significant change.

> In town centres there is a high concentration of listed buildings which have fallen out of use… issues occur, for example tenement flats perhaps worth around £60-80k and the whole building needs a repair which would cost £300k – it just doesn't get done…

a development site can be worth more than a derelict building.

Yes, [a VAT rebate scheme] would stimulate more demand and hopefully lead to more conservation. When we consider the 600 churches being disposed of, these are going to end up in the hands of individuals and companies or developers. They are going to benefit from a rebate scheme. It will lead to a saving on materials.

5.3 Use and availability of traditional skills and materials

5.3.1 Availability of traditional skills and training provision

It is widely accepted that there is a skills shortage in the built environment sector, which has been an issue for some time. Nearly half of all survey respondents say availability of skilled labour restricts the amount of repair and maintenance work on their listed properties to a considerable extent (Figure 5).

Of those respondents who said the availability of skilled/experienced labour was constraining their ability to commission work on listed buildings, 57% of survey responses[44] point to very short supply of relevant skills and experience. Nearly a quarter of survey responses state high prices and delays to work are also a notable concern (Figure 6).

44. Respondents were able to select multiple options

Figure 5: Does the availability of appropriately skilled and knowledgeable tradespeople/ contractors to conduct repairs and maintenance constrain how much work you commission?

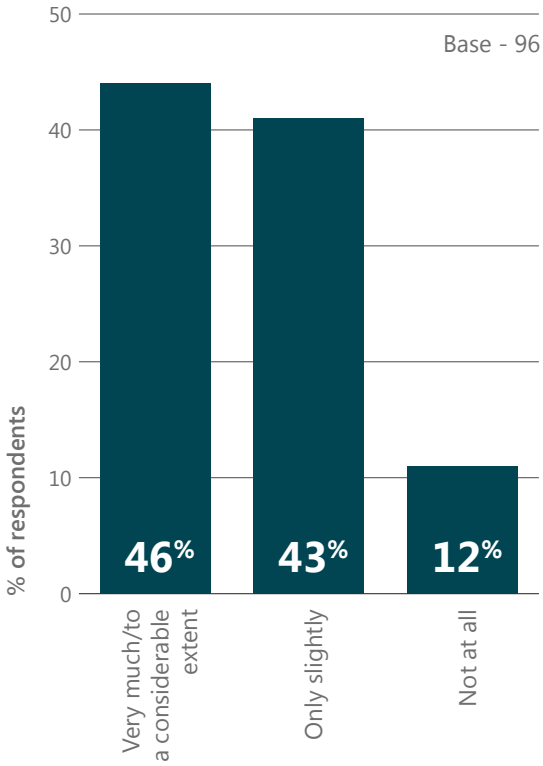
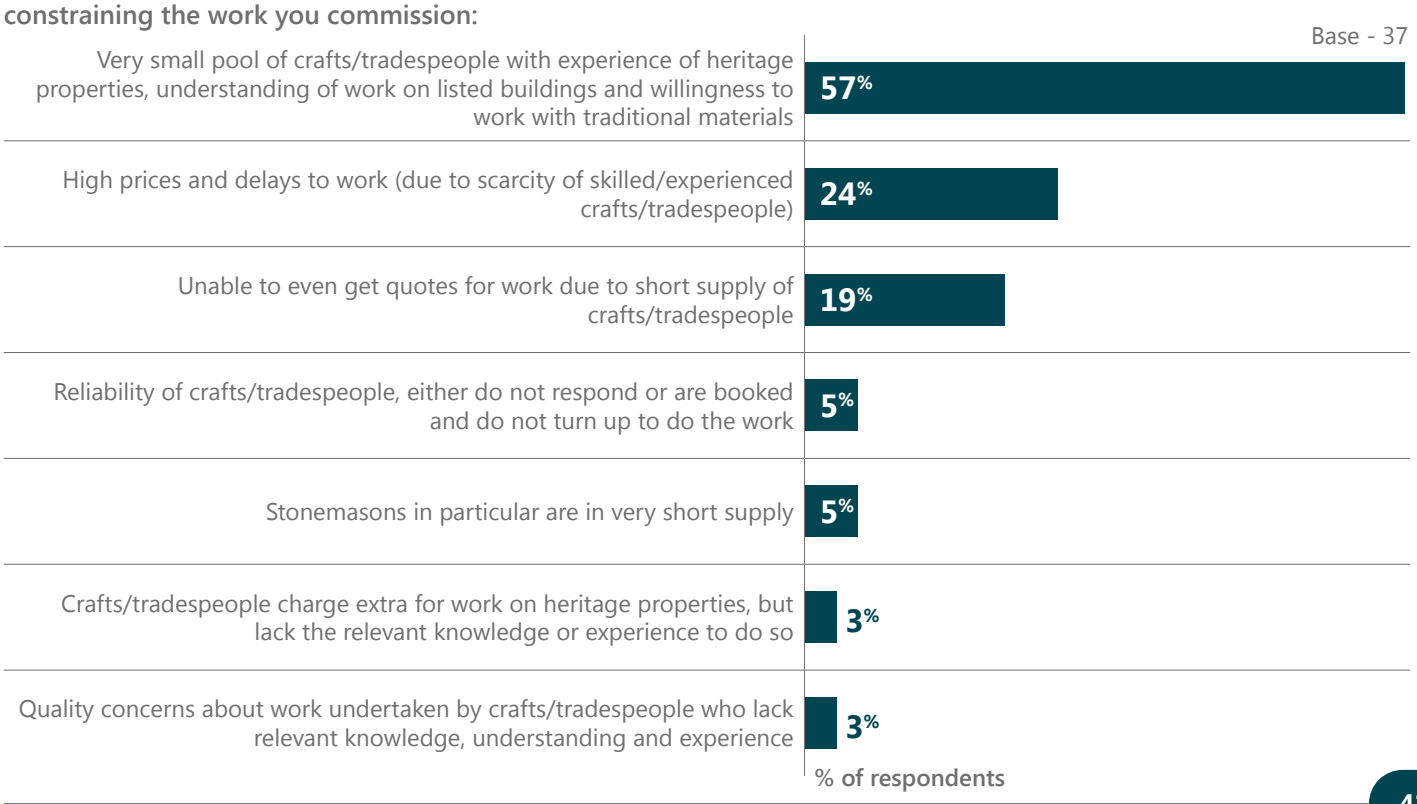


Figure 6: Please explain how the availability of tradespeople/contractors is constraining the work you commission:



As well as delays and higher prices, respondents say sub-standard work can arise from the issue of skills shortages, as listed property owners may undertake works themselves, or use tradespeople who lack the relevant knowledge and experience of working on traditional buildings.

> A lot of issues with incorrect works – much more [of a problem because of skills shortages] than backlogs. For example, roofing with leadwork, which is split or old, patched with temporary repairs rather than replaced. Inappropriate materials are being used, which causes problems further down the line, such as incompatible slate, cheaper slate – which may not have same thickness – leaving gaps and allowing penetration by wind driven rain.

Evidence from interviews finds stonemasons cited as a role in particularly short supply, exacerbated by limited training provision. Other roles causing concerns include traditional lime plasters, lead workers and roofers. Low numbers of apprentices are also deemed a major concern. Evidence from interviews with listed property owners and heritage stakeholder bodies indicates traditional skills are more readily available in Edinburgh and Glasgow; scarcity of relevant skills and experience is more common in the Highlands and Islands.

> Stonemasonry companies in Scotland all have full order books, they also have to pay their tradespeople a lot more. We have been trying to recruit stonemasons at the Scottish Lime Trust and we are having to increase the salary. Edinburgh College is no longer delivering apprenticeships in stonemasonry.

It is clear from the evidence that currently, training provision for traditional skills is in markedly short supply across Scotland. Accessibility is a major problem; where relevant training provision is available, it is not necessarily accessible, and when a skilled tradesperson can be found, it is costly to transport them – and the building materials – to harder to access places.

> How do we build [traditional building] skills when all the training is in the central belt?

> Scotland's geography includes the Highlands and Islands – to get a tradesperson to an island, accommodate them, with the right skills? Difficult. There are not enough of them, and costs are very high. Also, we have to get the materials there – another barrier – and adds to the cost.

Evidence analysed for this study indicates a VAT rebate scheme for listed buildings would be likely to stimulate upskilling, through increased demand for work, underpinning organisational level growth, creating more jobs in the process.

> Contractors need good projects to work on and grow, so if a VAT rebate stimulates more work, this could lead to an impetus for further training.

> If the incentive of VAT relief was to come about, it would probably drive the market for repair and maintenance work and encourage people to maintain properties which may help contractors by providing a steady stream of work. There is also a skills shortage, but this rebate, by stimulating more repair and maintenance work, may help to encourage the development of traditional skills out there.

> Any moves to offer incentives through the VAT route will, I would hope, act as a catalyst to training up more people in these heritage trades.

> Leadwork skills are in demand, but at the moment generally there is no real earnings incentive to train in heritage building skills – people enter as a vocation. There's a possibility that a VAT rebate could stimulate more training.

While respondents are confident about a VAT rebate scheme acting as a catalyst for upskilling and increasing availability of traditional skills, they point to two key limiting factors which could have an impact on how effective this would be. Firstly, the availability – and accessibility – of traditional skills training provision; secondly, the prospect of the cost-of-living crisis restricting the amount of works commissioned – even with a VAT rebate to reduce costs.

Respondents also raise concerns about educational policy and funding – noting that a long-term commitment is required to give SMEs the confidence to invest in apprentices and training.

> We need long-term funding commitment, a clear direction of travel. SMEs are not confident about taking on apprentices – what if there is a policy U-turn? Funding cuts in education have been common, and the political situation has been volatile. SMEs are the ones that need the confidence – it's typically SMEs taking on this type of work.

Respondents also suggest repair and maintenance work on listed properties could potentially be of better quality, over the long-term, if there is more upskilling and training in traditional building skills; though it is noted that this is likely to be some years before these impacts are felt.

5.3.2 Increased use of traditional materials

Affordability and availability of traditional materials are both cited as barriers to their greater use for repair and maintenance of listed buildings. Supply chain costs and inflation have more recently exacerbated the affordability issue. Long lead times can mean the cost of materials rise before the work even begins.

As is the case with traditional skills and training, availability of traditional materials is more problematic for the Highlands and Islands, due to the costs and time incurred to transport them. This can mean listed property owners revert to using the wrong materials, because it takes too long and/or costs too much, to source the traditional materials required.

> In more remote parts of Scotland, getting access to tradespeople will be more difficult, but it's also about having access to the right sorts of materials. You may have a tradesperson outside of the central belt choosing not to repair a sash window – instead putting in a new PVC window as they can access that easily.

> If you look at the city central belt – they are nearer to the supply chain, better connected with roads and ports. But if you look at the remote Highlands and Islands, they are further from the supply chain, so access to materials is more difficult there.

Respondents state traditional materials are more expensive in comparison to other types of building materials; this can also because of the need for bespoke design rather than being able to buy an 'off-the-shelf' product.

> Materials are more expensive, for example, lime instead of cement mortar and lead instead of zinc will always be more expensive.

> Materials could cost significantly more – a bespoke timber window might cost £3-4k versus around £500 for UPVC.

Respondents are therefore less confident that a VAT rebate scheme would have any notable effects in increasing the use of traditional materials, notably in the Highlands and Islands where they are harder to access. They attribute this partly to a lack of knowledge and understanding among listed property owners as to the 'right' materials that should be used. This in turn is influenced by the costs of seeking professional advice – not all listed property owners have funds available to use professional consultancy, though they recognise there are gaps in their own knowledge.

5.4 Energy efficiency and the journey to net zero

In addition to policy drivers accelerating Scotland's journey towards net zero, effects of climate change are being felt which are contributing to a general legacy of retrofit issues. Increased rainfall is cited as one of the most pertinent problems, which is starting to damage listed buildings where appropriate repairs are not being undertaken.

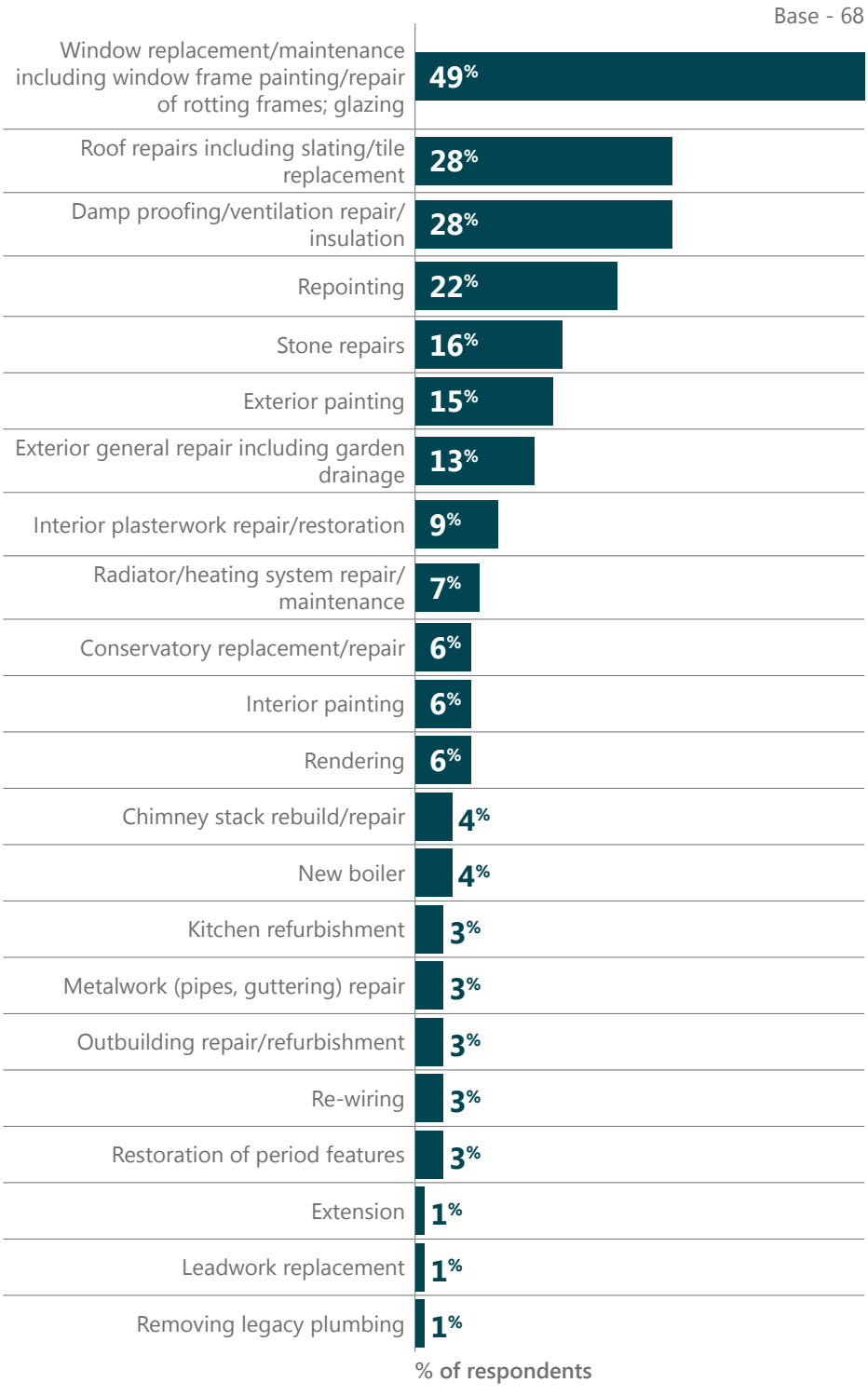
> "In the last 5-10 years, we have had huge rainfall. Rainwater goods such as downpipes are not coping with them.

> "Flashings, gutters, and fall pipes were designed when the climate was different and cannot manage current rainfall and extreme weather events.

Evidence from heritage stakeholder bodies suggests that rising fuel costs would drive listed property owners to tackle repair and maintenance works to improve energy efficiency, as a first port of call, were a VAT rebate scheme to be introduced. This is echoed in the survey data; the most common types of repair and maintenance work not taking place (because of insufficient funds) would all have an impact on energy efficiency in the property. Notably, window repair, roof repair (new slates/ tiles), damp proofing, insulation and repointing (Figure 7).

Trade bodies note a VAT rebate scheme would make a contribution to the circular economy.

Figure 7: What kinds of repair & maintenance are you delaying due to lack of funds?



> There are members who use waste for chippings, biomass, repairing. The carbon cost is less, because [they are using] natural products, which are re-usable – circular economy.

Several respondents say energy efficiency gains underpinned by a VAT rebate scheme could be at risk if the regulatory system is not sufficiently joined up. Respondents would like to see shared ownership of regulations relating to energy efficiency, decarbonisation and conservation.

> There are limits to what a contactor can do to improve energy efficiency of a listed building, because of regulations around conservation areas etc. For decarbonisation (but also for all work on listed buildings) there needs to be more flexibility around the regulations... Contractors on listed buildings find themselves caught in the middle. The regulatory landscape is a massive challenge when working on listed buildings.

5.5 Maximising potential positive impacts/benefits through effective implementation

A VAT rebate would be most welcome – but there are wider issues that would need to be tackled to make it work.

5.5.1 A VAT rebate scheme should not be viewed in isolation

As described at the start of this report, this is a highly complex issue, with numerous sub-issues which are not static. A VAT rebate scheme may be part of the solution – but it is unlikely that one tool in isolation is going to be enough. A broader toolkit is likely to be necessary to tackle the multi-faceted issues relating to repair and maintenance of listed buildings. A VAT rebate scheme should be part of a wider discussion about VAT reform more generally.

5.5.2 Education, knowledge and understanding among listed property owners

It is important to acknowledge the complexity of retrofit more generally. Evidence gathered for this study finds professional advice may be cost prohibitive for many listed property owners. While they recognise there are gaps in their own knowledge, they do not necessarily have the time or funds to plug those gaps – ultimately giving them the understanding of precisely what kind of work needs to be done/ commissioned, what type of materials are needed and crucially, what kind of skills and experience are essential for undertaking the works.

> There is limited understanding amongst the public of what is involved in looking after a listed building...in Scottish towns, there's lots of tenement living and I wonder to what extent people understand the responsibilities of individual owners within a single structure, relating to the fabric, roof, structure etc.

Respondents question whether listed property owners are aware of forthcoming legislative and policy changes – notably new energy efficiency standards. Stakeholders say communication and education of homeowners must be considered together – they need to be informed about any potential VAT rebate scheme, but concurrently they need to understand what types of work should be undertaken, to meet the specific needs of their listed properties.

> It's all about communication. You need to make people aware that there is a saving to be made.

> A 20% saving would be a very good enticement to owners addressing repair and maintenance needs on their traditional buildings... it would, however, have to be spelled out to homeowners that this is a saving.

> I think they [repair and maintenance backlogs] will be reduced by this [a VAT rebate scheme], but only in a pincer movement with better education of the public.

5.5.3 Timing and pace of a VAT rebate scheme – current economic pressures

In the current economic context and cost-of-living crisis, the extent to which a VAT rebate scheme may make a notable difference to the quantity and/or quality of repair and maintenance work undertaken on listed buildings in Scotland, is likely to vary by geography – with different communities facing different types of economic pressures – and personal circumstances/income levels.

> For some people, the cost of repair and maintenance is not an issue, and a VAT rebate might have just a slight impact and maybe an acceleration in plans for more work and an increase in quality. Others will be so affected by economic pressures right now that a VAT rebate scheme would make limited difference. The timing has to be right.

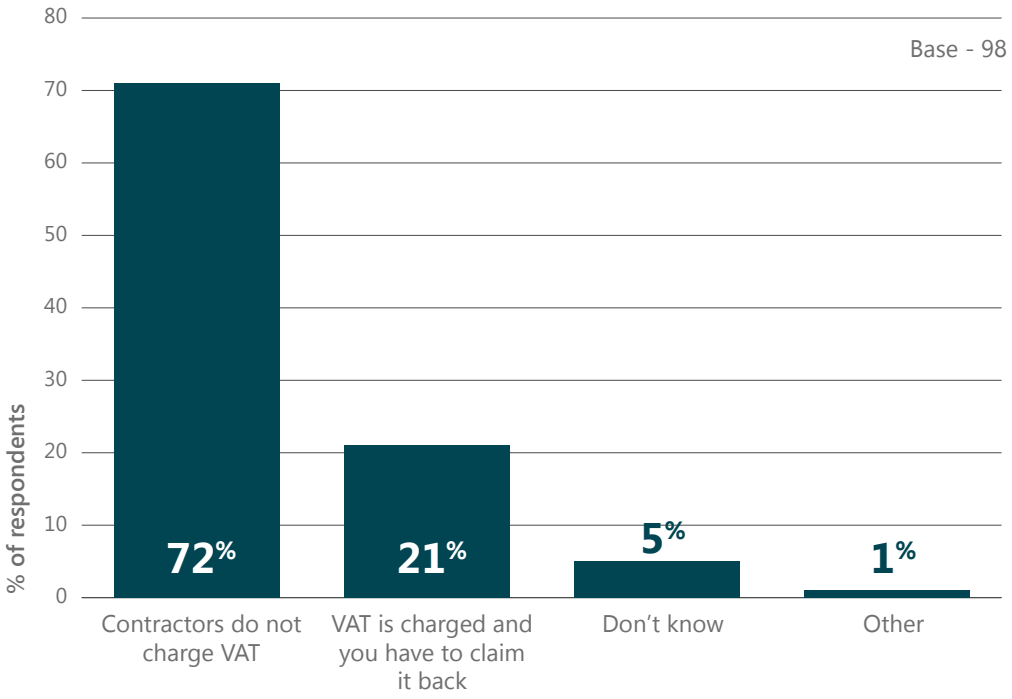
5.5.4 Make a VAT rebate scheme simple to administer

> Make it as easy as possible for people to benefit from it. Don't make the rebate system overly complicated or bureaucratic.

> The scheme needs to be as simple as possible: the contractor charges for works, but not for VAT. For this to work there needs to be as little bureaucratic onus on the contractors as possible. Paperwork is strangling lots of small firms.

Evidence from the survey finds that over 70% of respondents would prefer that contractors do not charge VAT at all, while just over a fifth of respondents say they would prefer VAT to be charged and to re-claim it back (Figure 8).

Figure 8: If a VAT rebate scheme was to be introduced, how would you prefer that it was managed?

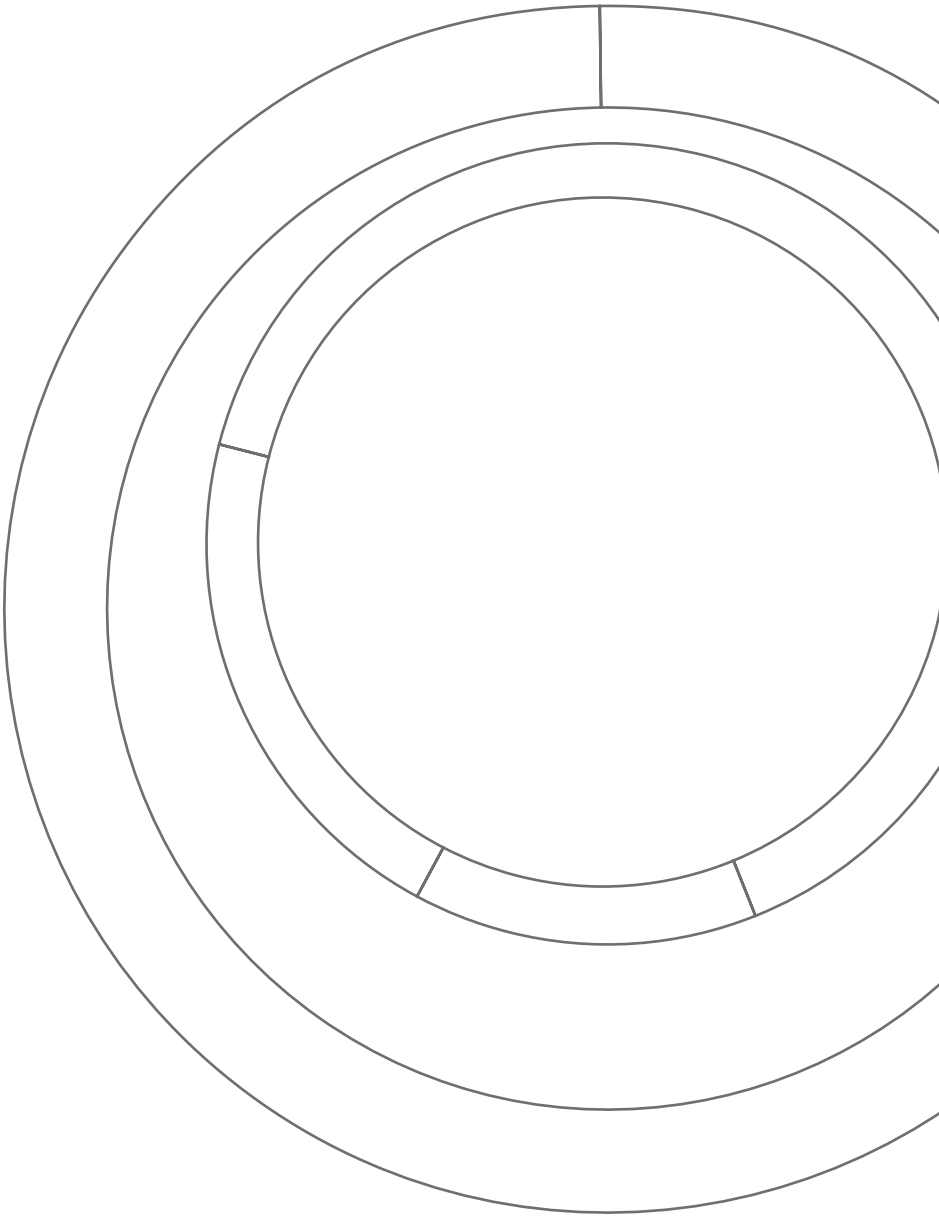


Industry stakeholders emphasise more strongly, a preference for VAT to be chargeable and then claimed back – on the basis that the process to do so is as simple and speedy as possible. A small number of listed property owners say they would not seek to reclaim their VAT back – because they lack faith in the system and perceive it to be overly bureaucratic.

Stakeholders note the importance of ensuring the VAT saving gets to the right people, able to harness the additional funds for the good of their properties – and unlikely to have been able to do so without some form of tax relief. They also emphasise the need to mitigate risks of unintended consequences that could arise from a VAT rebate scheme, such as higher prices (as demand increases) and/or work remaining of a less quality if there is not enough supply of skilled labour to meet demand.

> I wouldn't see any reason why contractors would change their prices unless the market becomes overheated. if this scheme did stimulate more building activity, the prices might go up as contractors would have more work than they can cope with, and they need to control what comes into their order books.

> The risk that if more people are incentivised to repair their listed properties, lesser skilled suppliers/ contractors may put in inappropriate measures. So, it comes back to skill levels again.



Key messages

6. Key messages

Undoubtedly, the subject of a VAT rebate scheme – and VAT generally – is a highly complex one. It is clear that there is a need for some sort of stimulus to boost the amount of works undertaken to preserve and sustain listed buildings in Scotland, underpinning conservation of heritage more generally across the country. There is a strong case for change – to preserve skills, the environment, and create stimulus for the economy.

Listed property owners are delaying essential repair & maintenance works due to a lack of funds; such works would not only sustain their buildings but contribute towards the energy efficiency agenda through actions like introducing moisture management measures, window repair and repointing.

This research estimates a direct cost of a VAT rebate scheme in Scotland for listed buildings is £47m. The net cost would be less than this – because of the stimulus to the economy and the effect on the black economy. The extent of the stimulus to the economy involves consideration of the elasticity of demand for ERM work on listed buildings and the amount of the rebate which contractors would pass on to clients. It should be noted that there are no robust data covering elasticities of demand in for construction ERM.

Furthermore, any consideration of increased demand assumes there is spare capacity in the supply chain. Other key considerations are the effect that a rebate would have on the black economy – would contractors currently operating in the black economy shift at least a proportion of their work into the formal economy?

These two factors – a £47m increase in demand and black economy activity transferring into the formal activity would increase tax receipts and lessen the direct cost of a rebate.

It should be taken into account that figures included in this report are estimates based on modelling which has drawn upon all available data, but there are notable gaps in the data sources which must be considered.

More generally, economics studies acknowledge that a VAT cut (not specifically a rebate, but a cut which amounts to a similar effect of generating more income for consumers) has the potential to stimulate spending, as illustrated below:

Income effect

A VAT cut/rebate puts money in the pockets of consumers by reducing their bills. IF these monies are used to make additional purchases, spending and economic activity are stimulated.

Substitution effect

Creates an incentive to bring forward purchases (taking advantage of lower prices during a VAT cut or rebate scheme), acting as a stimulus to demand.

Mutliplier effect

Income and substitution effect boosts output via a multiplier effect – increased demand for workers, in turn stimulating higher employment, higher earnings which in theory further boosts spending.

Evidence gathered and analysed for this research suggests a range of positive impacts could be realised as a result of a VAT rebate scheme – but this is not a linear, straightforward process whereby releasing money through a VAT rebate scheme would guarantee directly resulting in more work being undertaken on listed buildings, and the wider benefits which would accompany this.

There is no guarantee that a VAT reduction in itself would lead directly to repair and maintenance work becoming more economically accessible. Sentiment is positive, but this would not necessarily equate to behavioural change.

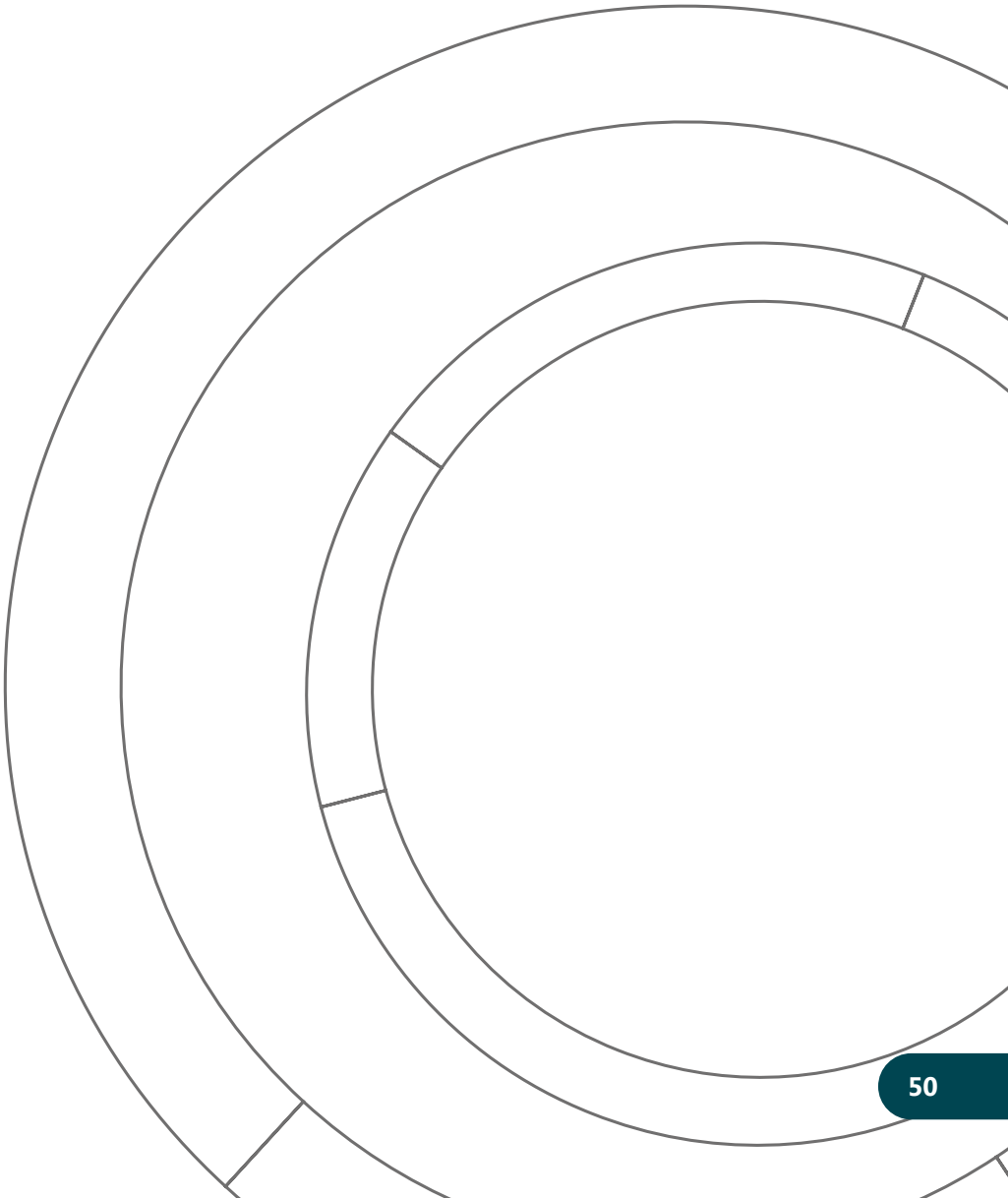
There is no guarantee that consumers will spend money saved via a VAT cut/rebate on additional purchases – in this case, commissioning repair & maintenance work. This is even more uncertain during a challenging economic climate – and the UK is currently experiencing a cost-of-living crisis. Achieving a stimulus is reliant on price reduction, so if there is some kind of loophole where the tax cut is not passed on to consumers, the impact of a scheme would be greatly reduced.

There is also reliance on having a supply chain in place able to meet increases in demand. As explained in more detail throughout this report, skilled and experienced tradespeople able (and willing) to work on listed buildings and produce outputs with the necessary quality (having been able to source and afford to use the right traditional materials) are in markedly short supply. It is challenging to cope with current demand; it may be too difficult for suppliers to handle increased demand, which would undermine the value/impacts of a VAT rebate scheme.

It is difficult to be assured of sustainability benefits, as the overall sustainability of existing buildings depends on the quality and appropriateness of the measures implemented, whether of routine repair and maintenance or retrofit – linking back to the skills and supply chain issue.

There is also the risk that a VAT cut/rebate could result in high amount of deadweight – i.e., taxes cut or reclaimable on ERM work that would have taken place anyway.

In this highly complex space, it is unlikely that one tool in isolation will resolve the issues.



Key considerations

7. Key considerations

This is not a simple issue, but a highly complex space, as outlined in earlier chapters. We have therefore elected not to make recommendations, but we outline below our key considerations for Historic Environment Scotland.

1 The introduction of a VAT rebate scheme, or indeed any form of VAT reform, is likely to have limited impacts if other key issues are not addressed first

- Any increase in potential demand for ERM works on listed property will place demands on the supply chain. There is little or no spare capacity. Contractors report long pipelines of work. There are skills shortages in construction generally and these are particularly acute in the specialist heritage sector.
- A stimulus to demand without spare capacity would stress the supply chain and potentially lead to inflation, and the rebate being absorbed by increase in contractors' prices. There are also other risks of unintended consequences, if less skilled contractors are attracted by an increase in demand, potentially leading to sub-standard or inappropriate works being carried out.

2 Therefore, the first priority must be tackling the skills gaps and shortages in the supply chain

- This could involve advocating for additional funding for training courses (noting that there are severe limitations in supply of relevant training in some parts of Scotland, notably more rural areas), funding and support for apprenticeships, and/or other forms of support such as mentoring, traineeships or similar.
- Lack of skilled people in the supply chain is a substantial problem, and not one which is likely to be resolved quickly. It is also an issue that would require multiple actors to influence change, not just Historic Environment Scotland. Other key stakeholders would include funding bodies, the Scottish government and colleges/ training provider networks, as well as industry.

3 It should be noted that VAT reform is not the sole solution, or indeed may not be the optimum solution – other policy instruments could be considered

- A VAT rebate is essentially a blunt instrument intended to solve a complex set of problems; other initiatives could be considered to be used alongside or instead of a VAT rebate. It is important to recognise that success associated with a VAT rebate or VAT reform more generally is heavily reliant on a specific set of circumstances – notably having sufficient supply of skills to respond to the increased demand, and the will of consumers to actually use additional monies for ERM work. The first will require significant time and investment, while the second is dependent on many factors including the economic climate – which is outside of the control of organisations like Historic Environment Scotland.
- General VAT reform could be considered to level the playing field between new construction works and ERM. It would rely on UK government support, the timescale for implementing this would be longer – it would not be a quick win.
- The most effective solution may be a coordinated policy 'toolbox' rather than individual policies implemented in isolation; there are still no guarantees that a range of policy interventions would work in the current context.
- These could include direct grants for ERM work; and free or subsidised access to professional advice. Further research would be required to assess how such grant aid would be funded, through which bodies.
- Regardless of the instrument(s) used, to avoid deadweight i.e., refunding VAT on works or grant aid where this provides little societal benefit e.g., on new kitchens and bathrooms, a more targeted approach should be considered, where support is only available for works for which there exist backlogs and which are crucial to a low carbon agenda or necessary to halt deterioration, such as work on windows, roofs, and/or repointing.
- There should be consideration of whether any form of intervention is permanent or temporary. If temporary there is a risk that prices will increase when a scheme ends. Contractors are wary of 'stop start' policies which confuse and undermine long-term planning.

4 Potential consumers must be made aware of any form of VAT rebate, reform or indeed any other intervention for impact to be realised and maximised

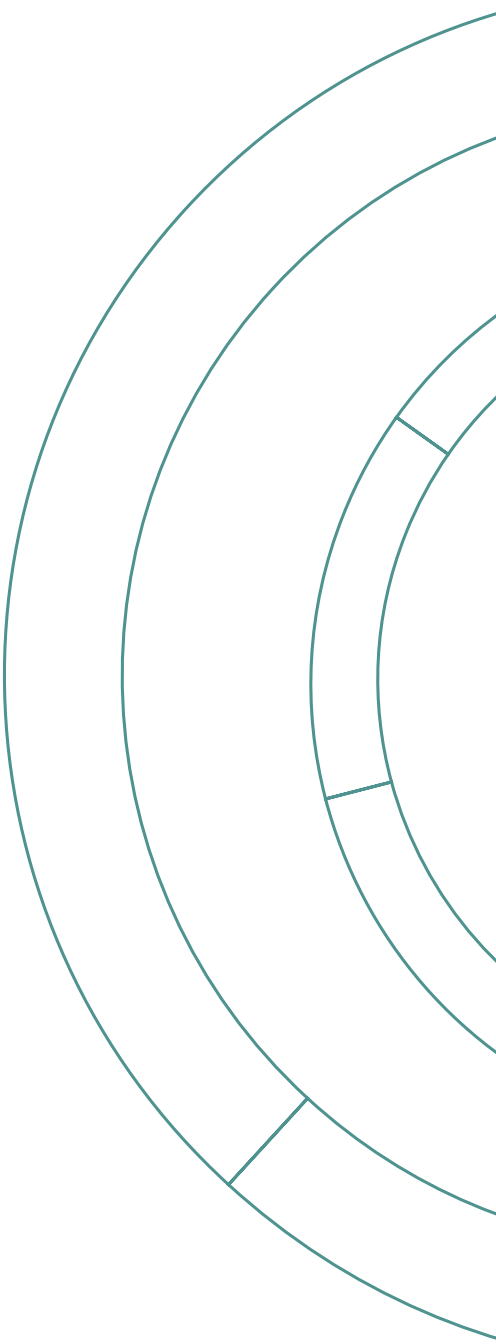
- For any intervention to work, potential consumers need to be aware of it. Further research is likely to be needed into the potential impacts of other policy instruments such as grant funding, but regardless of the approach – it must be accompanied by a consumer awareness campaign targeting the wide range of owners of listed property. Alongside awareness of any new interventions, consumers should be made aware of other existing grants or funding for which they are eligible. For funds to be spent effectively it is essential that consumers have some technical knowledge of what constitutes appropriate works for listed property; there should be signposting or an education campaign.

5 This report should be viewed as the first step in understanding this complex issue and actions that could be taken

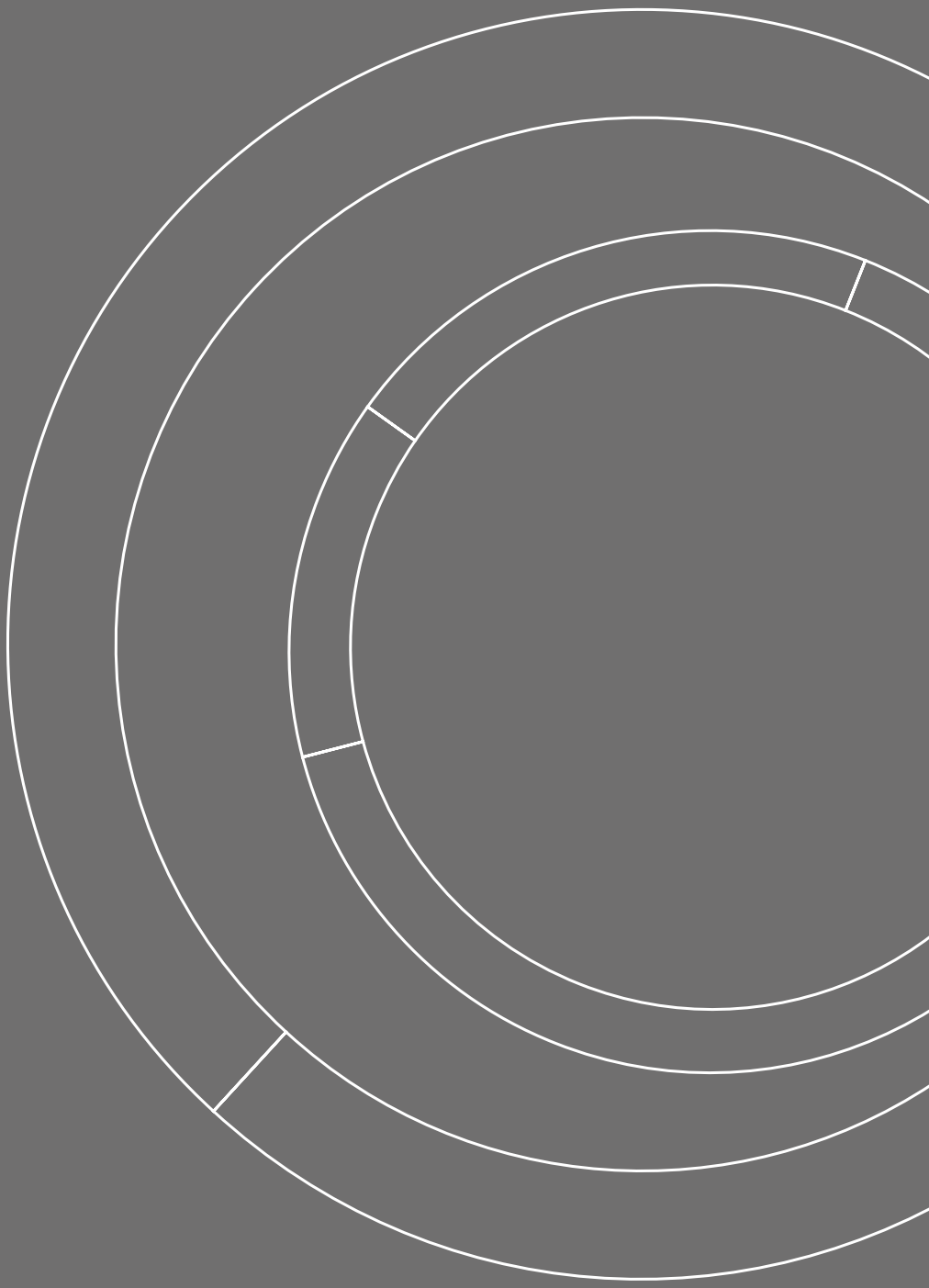
This research has been complex, with challenges in its implementation – notably limitations in the availability of data. Further research may be required to test potential impacts of alternative approaches. Future studies should seek more detailed insights from developers to ensure a rounded perspective.

Research of this type could be carried out more effectively if more specific data were in the public domain.

- An overview of all Scottish Listed Building Consent planning applications would be helpful, currently these are aggregated with Conservation Area Consent applications.
- Analysis of planning data would be more accurate if there was consistency across all planning authorities in terminology for planning decisions, successful applications are variously referred to as e.g. 'Approved', 'Granted', 'Deemed Approved'.
- Publicly available data covering listed buildings is scarce. For this research data from commercial provider Verisk was used to calculate relative areas of domestic and non-domestic listed buildings. Publicly available data including area, condition; type i.e. domestic/ commercial; and ownership i.e. private/public would have been helpful.
- Detail covering EPCs for listed buildings could inform any future research concerning Scotland's net zero future.
- ONS data covering Repair and Maintenance includes domestic extensions but excludes non-domestic extensions, this causes some difficulty when attempting to arrive at aggregate figures for Extension Repair and Maintenance. Consistent data would help to simplify analysis and potentially improve the accuracy of outputs.



Appendices



Appendix 1: Research methodology

1. Research challenges

At present, there has been a considerable amount of published research on the potential impacts of a VAT-reduction on construction repair, maintenance and alteration, but much of this has a broader scope than listed buildings and, moreover, involves substantial uncertainties.

There two basic approaches to estimating the current level of expenditure on repair, maintenance, and alteration to listed buildings. One is starting with the existing data for the size of the total market for repair, maintenance and alteration and estimating what proportion of that total is represented by listed buildings. The other is to start with detailed study of a sample of micro-level data about listed building-repair and then 'gross up' to estimate a total value.

There are intrinsic challenges to the first approach rooted in the way that official statistics for the output of the construction sector are compiled and reported. Repair, maintenance, and alteration are accounted for differently in the figures for residential and non-residential construction, with the former including alteration and extension and the latter excluding it and classing it with new build output. This means that extracting consistent data for the value of building repair, maintenance, and alteration across the two sectors is challenging. Without consistent top-level data it is difficult to build on this to work out what proportion of that total is represented by work to listed buildings.

There are also no current robust data on the size of the construction 'informal economy', even though this is known to be substantial and, at least in part, driven by attempts to evade VAT. Thus, sector research continues to use estimates based primarily on a single survey carried out in 1996, more than 25 years ago. This is problematic from two points of view: first, it makes it difficult to gain a clear sense of the total output of this kind of construction work; second, if VAT were to be reduced or zero-rated for building repair, maintenance and alteration, this would be likely to lead to transfer of at last some work currently in the informal economy into the formal economy, as the benefit of non-compliance will be reduced. In the case of applying a reduced, rather than zero, rate, this could boost VAT income to the Treasury, offsetting some of the cost of introducing the reduced rate.

This would tend to suggest that building upwards from micro-level data may be a more promising approach to calculating the value of repair, maintenance, and alteration. Here, however, the challenge is identifying sources of information that could be used to provide initial figures. There are substantial amounts of information about certain types of works to listed buildings in applications for Listed Building Consent (LBC), which are publicly available through the Public Access planning portals of UK local planning authorities. However, these are intrinsically biased towards larger and more complex works. In addition, the LBC applications do not include valuations for the works, meaning that they must be valued before they can be used for further calculations. Estimating the value of building works from plans and specifications is an uncertain business at the best of times and there are substantial costs for professional time and expertise for such work. No less importantly, it is clear that even after receiving LBC not all applicants go on to complete the proposed works and there are no currently available statistics about the proportion of applications that are completed as planned.

In Scotland, building warrant applications provide a more comprehensive sources of information for works planned and include outline valuations of the works. However, listed buildings are not a separate category of application as they are in the wider planning system and the values given are only for the works requiring warrant, rather than all the works proposed.

The alternative to using publicly available data is to conduct survey work with clients and contractors. The challenge with the former is the relatively small number of people who own or care for listed properties. This means a large initial sample is needed to generate a statistically robust sample of listed property owners. This can be avoided to some extent by choosing a sample frame that includes only or largely those who own listed properties (the approach used in this project), but in most cases the frame itself will have self-selecting features that may compromise its representativeness.

2. Detailed research methodology

Quantitative data analysis

Planning Authority data

The three main quantitative outputs required of the research are listed below:

1. How many changes are made to listed buildings each year?

It should be noted that the number of changes which require listed building consent can be derived from planning authority portals. There are no data for changes which do not need consent.

2. What is the monetary value of these changes?

While planning authorities list work which requires consent, there are no data which directly apply costs to this work.

3. Were a VAT rebate to be introduced in Scotland how much would the approximate cost of refunding VAT payments to works to listed buildings be annually?

Calculation of this figure requires data for 1 and 2 above. This also requires an understanding of the elasticity of demand for repair and maintenance works, i.e., how demand might change if owners of listed property were effectively charged less for repair and maintenance. Alongside the above there must also be an estimate of the wider effects of a stimulus on the Scottish economy including consideration of the economic multiplier for construction and the effect this would have on tax revenue.

Given these data challenges, it should be noted that no methodology will deliver a precise figure.

Planning data covering Listed Building Consents for the 32 planning authorities in Scotland is not aggregated in any official statistics. The Scottish Government Planning Performance Statistics publishes a table of Listed Building Consents and Conservation Area Consents[45], these are not listed separately. For 2021/2022 there are 3,050 applications listed. In order to gather data for the number of Listed Building Consents it was necessary to visit planning portals for each of the 32 planning authorities and perform advanced searches. A total of 2568 decided, granted, and approved Listed Building Consent applications was found for the full year of 2022.

Each application consists of a hyperlink to documents covering the application, these vary in detail between applications depending on the complexity of the application, but generally consist of a description and plan of the proposed works; the address; and the status of the application.

Keyword searches were performed to chart the types of changes applied for, e.g., extensions, roofing, and windows.

In order to estimate the total value of works requiring Listed Building Consent a random sample of applications was selected and all documentation downloaded. A specialist heritage Quantity Surveyor valued each application in the sample.

Analysis of Verisk data

Verisk Analytics is a multinational data analytics and risk assessment company. Verisk premises data for Scotland was analysed by premise area and count, listing category, use and age. The data cover almost 42,000 listed premises in Scotland and 2.2 million unlisted premises. Analysis of the data enable calculation of the relative areas of listed premises and unlisted premises.

45. Scottish Government Planning Performance Statistics 2021/2022
46. Output in the construction industry subnational and subsector reference tables

Process for mapping Listed Building Consent (LBC) applications

The aim is to collate all LBC planning applications in Scotland for 2022.

For each of the 32 Scottish planning authorities:

1. Visit planning portal
2. Select Advanced Search
3. In the "Application Type" dropdown click "Listed Building Consent"
4. In the "Decision" dropdown choose "Approved" and if present "Approved with conditions"
   For some Authorities there are variations on the terms above e.g. "Granted", "Granted with conditions"
5. In the "Decision date" section select 01/01/2022 to 31/12/2022
6. Select "Search"
7. Copy and paste results into a separate Excel sheet for each Authority
8. Check for duplicate Application Reference Numbers
9. Repeat the above for all Planning Authorities
10. Check for duplicate Application Reference Numbers
11. Summarise subjects of the set of applications, for reporting

National statistics

The main source of national statistics analysed were ONS data: Output in the construction industry subnational and subsector reference tables.[46] From this source it was possible to extract repair and maintenance output figures for housing, public other, private other and infrastructure.

Listed Property Owners Club survey

The Listed Property Owners Club is a membership organisation providing support to owners of listed property across the UK. There are 2000 members of the organisation in Scotland. The club agreed to circulate an online survey to its Scottish membership. The survey questionnaire was formulated to include qualitative and quantitative questions, covering: owners' spending on extensions, repairs improvement and maintenance; constraints on their spending; maintenance backlogs; and how this would be affected by a VAT rebate. The survey received 98 responses. Open-ended questions meant this source also generated detailed qualitative data.

Qualitative data analysis

Depth interviews were conducted with 'Trade' and 'Heritage' stakeholders. Trade stakeholders were chosen to represent the main trades in repair and maintenance including specific heritage trades. Heritage stakeholders were chosen to give the owner perspective on listed property repair and maintenance. Topic guides for each stakeholder group comprised a mix of quantitative and qualitative questions.

Desk research

Previous research covering repair and maintenance, parliamentary reports, and homeowner/industry surveys were analysed. VAT regulations and their application to the construction sector were analysed in detail.

3. Approaches to modelling

Supply side models

Top-down supply model

The equation on which the top-down supply model is based is shown below.

$$E = (((L/A)*(T))*V)$$

E	Expenditure on Listed building Extension, Repair & Maintenance (ERM)
L	Area of listed premises
A	Area of all buildings
T	Total expenditure on construction R & M
V	Adjustment for price differential for work on listed premises

The equation is refined below to separate domestic and commercial buildings.

- Verisk data is listed by count of premises, listed grade and use. Gross area for premises is a value Verisk derive by multiplying ground floor area by number of storeys.
- Ac and Ad the areas of *all* commercial premises and all domestic premises respectively, are derived from Verisk data by adding areas for the two residential categories 'Residential' and 'Residential with retail below'.
- Lc and Ld the areas of *listed* commercial and domestic buildings respectively, are derived from Verisk data by adding areas for the two residential categories 'Residential' and 'Residential with retail below' for each of the Scottish listed building categories A, B and C, and summing these.
- V is an adjustment figure for the price differential for work on listed buildings, which is calculated from an estimate of the cost differential ratio for work on listed buildings compared to non-listed buildings. This is derived from desk research and stakeholder interviews.

$$E = (((Lc/Ac)*(Tpo+Tco))*V) + (((Ld/Ad)*(Td))*V)) + M + Tb$$

L	Lc	Area of listed commercial premises
	Ld	Area of domestic listed premises
A	Ac	Area of all commercial premises
	Ad	Area of all domestic premises
T	Tc	Reported expenditure on commercial premises
	Td	Reported Expenditure on domestic premises
	Tb	Non reported expenditure (Black economy and DIY)
ONS	(Td)	Housing ERM expenditure
	(Tpo)	Public other R&M* expenditure
	(Tco)	Private other R&M* expenditure
	M	*Value of non-domestic extension work (ONS data for R&M non-domestic (other) do not include extensions.) on listed buildings.
	Tb	Non reported expenditure on listed buildings i.e. black economy.

Limitations

- There is an assumption that the area of buildings is the key determinant of the amount of expenditure on repair, maintenance and modification. It is possible that other factors, such as building age, materials, condition etc have an impact on the level of expenditure. These may be difficult to take account for accurately, for example:
- Condition: a building in good condition might be expected to need less expenditure than one in poor condition; but the building in good condition may simply reflect greater routine expenditure, and the building in poor condition less routine expenditure.
- Roofing type: It is known that many flat roofed buildings (notably those with felt coverings) require more frequent major roofing works than pitched roof buildings; buildings with pitched roofs require less frequent, but generally more costly, major works, and more frequent minor routine maintenance, such as replacement of tiles.
- Building use: commercial buildings may well be more frequently renovated/ refurbished than domestic buildings. Different sizes of buildings may also lead to different expenditure levels: e.g. larger houses may be owned by wealthier owners, and benefit from higher expenditure than smaller houses, whereas there may be large historic commercial buildings (factories, warehouses) that struggle to find reuse and may therefore be subject to minimal expenditure.
- Building location: buildings in economic centres, particularly large cities, may benefit from high expenditures levels than those in less economically active areas (e.g. Edinburgh, Glasgow, the Central Belt in general might be expected to be high demand areas). There may also be rural versus urban effects.
- There is an assumption that the profiles of the listed building stock and the wider building stock (in terms of use and building size, type, age, condition etc.) are broadly comparable, as if they are not any differential spend will impact on the relative proportions of total spend in the listed and non-listed sectors. There are good reasons to think that the listed and non-listed building stocks have different profiles in most key variables).
- There is an assumption that the average cost of works to different types of listed buildings are similar, when there are reasons to suspect that works on highly listed buildings (Category A) are likely to be considerably more costly than those on many other listed buildings.

The ONS baseline figures may not be 100% accurate and this should be taken into consideration.

Alterations, extensions, major refurbishment are treated differently in ONS statistics for construction output:

- New construction work includes – extensions, major alterations and improvements, site preparation and demolition, except for housing, unless the works are conversion of existing housing for other uses, in which case it is included within new construction work.
- For housing – improvements, extensions and alterations and house/flat conversions are included in repair and maintenance.
- For works other than housing an estimate has to be made of the value of extension works.

Bottom-up supply side model

The bottom-up supply model takes the total expenditure on ERM and multiplies this by the proportion of contractors' work which is carried out on listed buildings.

The basic equation is shown below.

$$E = (Wl/Wt)*T + M + Tb$$

E	Expenditure on Listed building ERM
Wl/ Wt	The ratio of contractors' ERM work carried out on listed buildings to their total ERM work
T	Total expenditure on construction ERM
M	Value of non-domestic extension work (ONS data for R&M non-domestic (other) do not include extensions.) on listed buildings.
Tb	Non reported expenditure on listed buildings i.e. black economy.

Limitations

Calculating the relative proportion of contractors' ERM work carried out on listed buildings is informed to a large extent by interviews with contractors and trade membership organisations.

- There are difficulties ensuring that contractors contacted and responding accurately represent the sector as a whole, leading to response bias.
- Contractors may lack awareness of whether work is being carried out on a listed building.
- There may be complexities resulting from certain large contractors specialising heavily in work on listed buildings (e.g., Restorex in Edinburgh), meaning that there may be significant outlier effects that may be difficult to account for.
- There may be challenges accounting for long left-tail issues, due to the large number of micro contractors working in the sector who may not captured adequately through interviews with contractor organisations or through response bias (though these are likely to be of less significance in VAT terms as many will not be VAT-registered).

Demand-side model

This is a calculation which derives the total of ERM work on listed buildings by taking the ERM work requiring Listed Building Consent (LBC).

Limitations

- LBC works represent an unknown proportion of all works carried out on listed buildings.
- There is no record of expenditure relating to LBC applications, meaning that the only way of ascertaining cost is through direct contact with the applicant or by estimating the cost from the description of the works contained in the application.
- Making accurate estimates of LBC works is challenging – costs vary widely from one contractor to another, and variation is likely to be greater with small projects, especially in periods of high demand when availability of skills is inadequate, allowing contractors to inflate prices.
- There is an assumption that works are carried out immediately after decision. However, works may be applied for but may only be carried out after a substantial time delay or not at all. In addition, some works may take a lengthy time to complete. On the other hand, some works are in fact begun before LBC is granted or are the subject of retrospective applications. This may make allocation of works to financial years unreliable.
- Outlier effects right tail – stockholders with very large/ important buildings undergoing major refurbishment, or with numerous listed buildings, such as major estates, relevant; or left-tail – lots of small stockholders with relatively modest expenditures but which may in total amount to considerable expenditure.

Further calculations

The three main quantitative outputs required of the research are listed below:

1 How many changes are made to listed buildings each year?

It should be noted that the number of changes which require listed building consent can be derived from planning authority portals. There are no data for changes which do not need consent.

2 What is the monetary value of these changes?

While planning authorities list work which requires consent, there are no data which directly apply costs to this work.

3 Were a VAT rebate to be introduced in Scotland how much would the approximate cost of refunding VAT payments to works to listed buildings be annually?

Calculation of this figure requires data for 1 and 2 above. This also requires an understanding of the elasticity of demand for repair and maintenance works, i.e., how demand might change if owners of listed property were effectively charged less for repair and maintenance. Alongside the above there must also be an estimate of the wider effects of a stimulus on the Scottish economy including consideration of the economic multiplier for construction and the effect this would have on tax revenue.

Given these data challenges, it should be noted that no methodology will deliver a precise figure.

Appendix 2: Profile of survey data respondents

This appendix includes the profile of the respondents who participated in the survey (Listed Property Owners Club members in Scotland). We are grateful to the management team of the Club for enabling this survey to be distributed among their members and we thank all concerned for their valuable input into this research.

Figure 9: Can you confirm that you are responsible for the maintenance of a listed property?

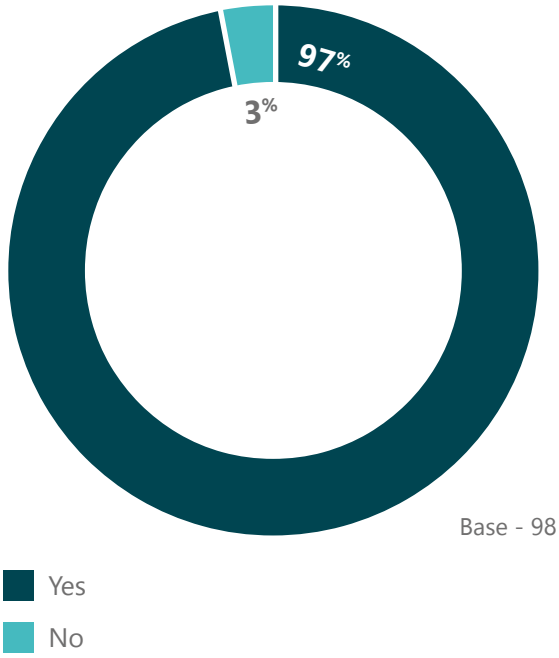


Figure 10: What type of listed property are you responsible for?

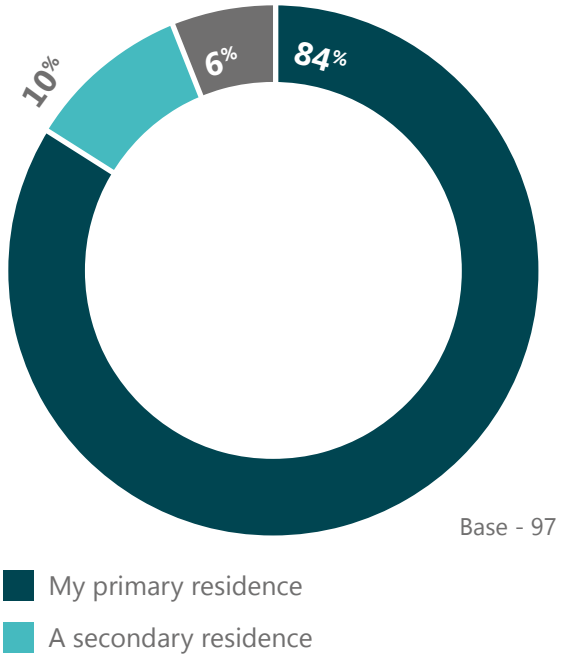


Figure 11: What is the designation of the listed property?

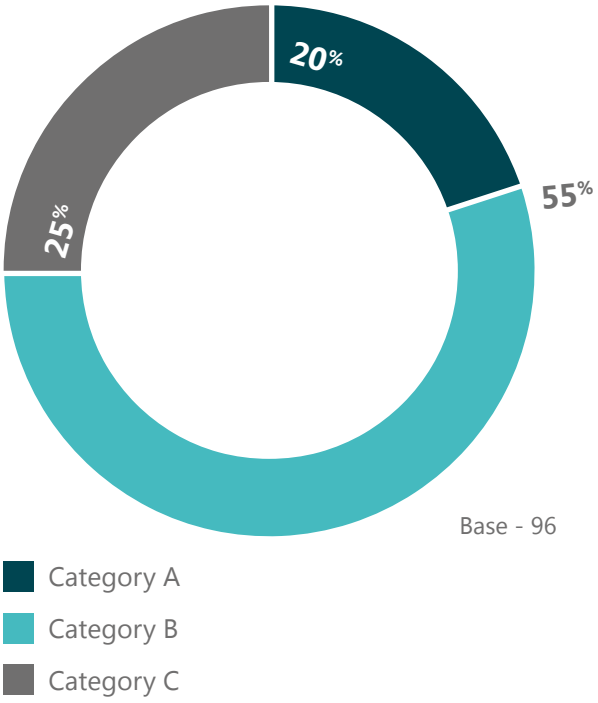


Figure 12: Please tick which option most closely describes your property:

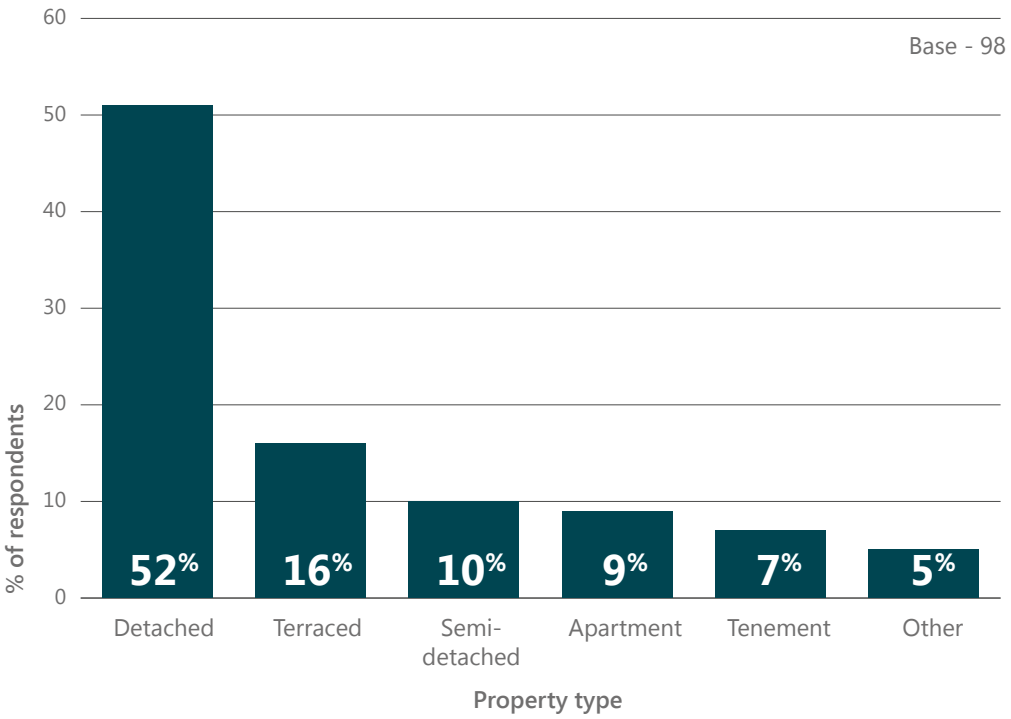


Figure 13: What is the approximate value of your property?

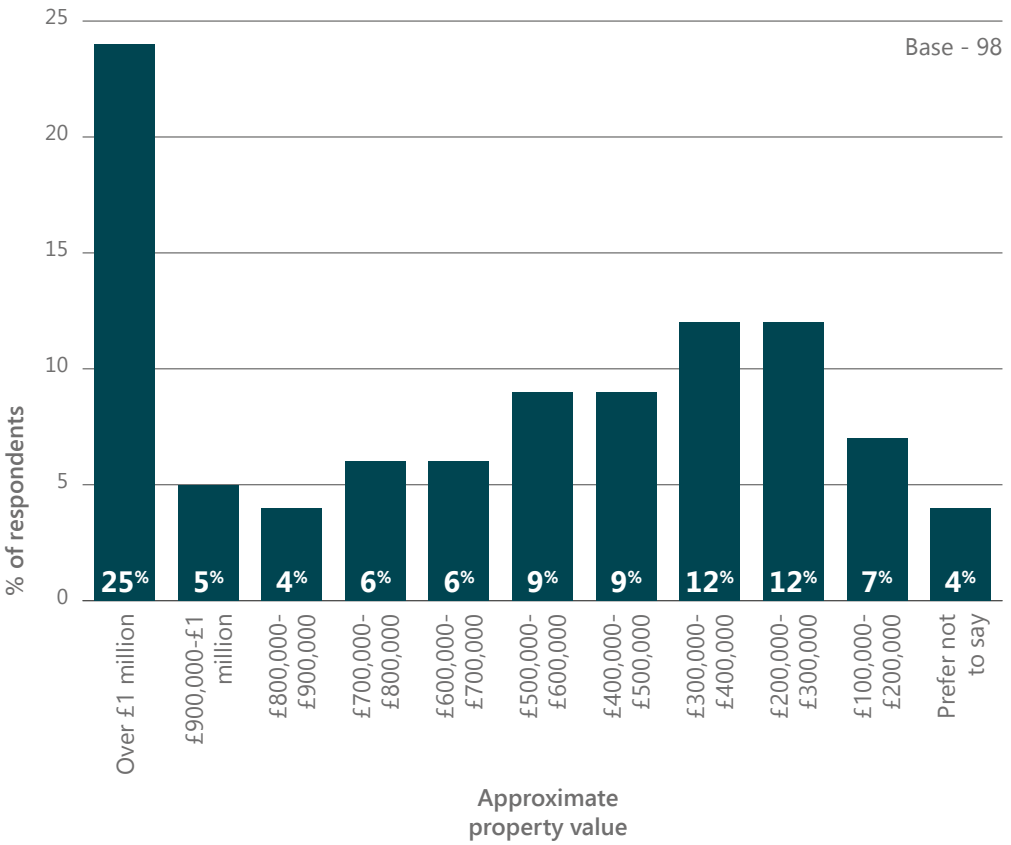
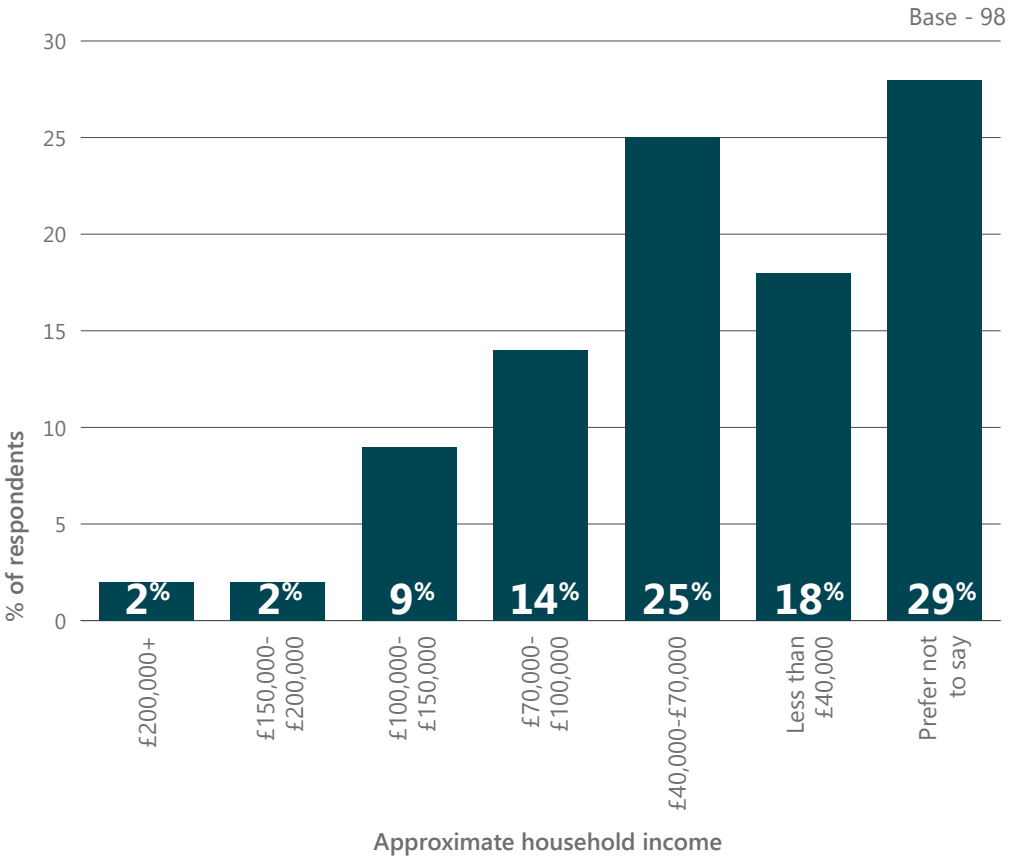


Figure 14: What is your approximate household income?



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