Property taxation and land use policy

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The CIOT has responded recently to government consultations on land use and energy performance in the private rented sector to underline the need to consider taxation as part of wider policymaking.

The CIOT recently responded to two government consultations: the Department for Environment, Food and Rural Affairs' (DEFRA) consultation on a land use framework; and the Department for Energy Security and Net Zero's (DESNZ) consultation on improving the energy performance of privately rented homes. Although taxation was not the focus of either consultation, we responded with the aim of ensuring that tax is considered as part of the policy review overall to ensure that government proposals work as intended.

Land use consultation

The consultation by DEFRA on land use sets out an analysis of the scale of long-term land use change required to deliver the government's missions for growth and clean

energy, to boost food security and to meet statutory climate and nature targets. It is intended to support the government's commitment to building 1.5 million homes.

The key messages in the CIOT response were:

- A clear strategy for the taxation of land, property and construction is needed to underpin effective cross-governmental engagement.
- Taxation should form part of that cross-governmental working at an early stage, to ensure that the tax position as it affects land use coheres with wider government policy.

Without a clear taxation strategy, the tax system tends to become becomes divorced from, and may conflict with, wider strategic content. There are several areas in which the policy rationale for certain reliefs is unclear; for example, the recent changes to agricultural property relief for inheritance tax. This in turn makes it difficult to anticipate the intended interaction between such reliefs and other land-related policy objectives. such as environmental schemes or food security.

If consideration of taxation is absent from cross-government policy design, or tax is included at too late a stage, the successful implementation of the policy is likely to be undermined or delayed by uncertainty in relation to arising tax issues, sometimes with unintended consequences. A current example of where tax appears to have been considered at a stage when the policy was already in place is the development of biodiversity net gain and other private investment mechanisms for improving natural capital. This has caused uncertainty for the VAT treatment and the VAT recovery position on costs.

In terms of housing supply, we said that it is important to recognise that the tax treatment of land is a key driver in property decision-making by landowners whose land may be suitable for housing development. Aspects of the current tax system provide tax barriers to housing supply; for example, the tax system includes features that give rise to potential dry tax charges, loss of reliefs and potential double charges where multiple owners of different plots are involved in land assembly for housing development. Identifying tax barriers to housing supply that do not reflect government policy is, we suggest, essential to the development of the land use principles and co-design.

Our response underlines the need for tax policy to remain aligned with developments in wider policy, for example, real estate investment trusts (REITs)

make up a significant component of the built sector. The tax legislation identifies which classes of income are included in the regime. It does not include the business activity of generating renewable energy off-site (for example, from solar/wind farms) to directly meet the energy demands of tenants and reduce carbon emissions from the buildings in REIT portfolios.

Evaluating specific tax regimes against wider strategic policy as part of cross-governmental co-design seems a positive step. The government's consultation on energy performance in the private rental sector (see below) and the upcoming consultation on land remediation relief also provide opportunities to ensure wider policy and taxation are coherent.

The full CIOT response is available here: www.tax.org.uk/ref1467.

Improving the energy performance of privately rented homes

The DESNZ consultation considers how to improve the energy performance of privately rented homes by raising minimum energy efficiency standards.

The government's preferred approach is to require landlords to prioritise meeting a standard set against the fabric performance metric, which is likely to require similar 'improvement' measures as meeting an Energy Performance Certificate (EPC) 'C' on current EPCs, such as loft and cavity wall insulation, and double glazing. Once that standard is achieved, the landlord would need to invest to meet a secondary standard set against either a heating system metric (for example, a heat pump instead of fossil fuel heating system) or a smart readiness metric (such as solar panels and smart meters), depending potentially on the type of property and landlord choice.

It is proposed that landlords should be required to invest up to a maximum of £15,000 (inclusive of VAT) per property on 'improvements' to meet the standard (the 'cost cap'), after which they could register a ten year exemption to continue to let the property if it does not reach the standard.

Repair versus improvement

The CIOT highlighted that the measures needed to upgrade rental properties will bring the complexity around deciding whether costs are repairs (revenue) or improvements (capital) into sharper focus for many taxpayers and agents.

We noted that HMRC currently accepts that where technology has advanced so that the modern-day equivalent is the industry norm, a replacement that may formerly have been regarded as an improvement, and therefore not deductible against rental profits, is now accepted as being a repair.

While the manual guidance is helpful, it also recognises that changes in technology and the way that work is carried out will often give the impression that the work may be an improvement rather than simply a repair. Examples of areas of uncertainty might include replacing a conventional boiler with a condensing boiler, or with an air source or ground source heat pump; replacing single glazing with triple glazing; and upgrading insulation.

We suggested that tax (and non-tax) guidance for landlords on the tax treatment of repairs and improvements is expanded to include dedicated examples of the sort of measures envisaged by the government to remove these uncertainties.

From a policy perspective, consideration might need to be given to whether the tax treatment coheres with the government’s wider policy in this area. The current approach can appear inconsistent; for example, where the initial fitting of insulation is treated as an improvement, while replaceing a minimal level of insulation that is already in place is treated as a repair.

VAT

In addition to the repair versus improvement point, we highlighted the impact of the differing VAT outcomes on the proposed cost cap for improvements of £15,000 (gross) per property. The consultation noted that the current zero-rate of VAT on the installation of specified energy saving materials (ESM) in residential accommodation and relevant charitable buildings ends on 31 March 2027, after which it reverts to the reduced rate of VAT of 5%.

We also highlighted that the VAT liability of ESMs can be affected by the way in which the improvements are carried out. It can be common for landlords to undertake further works of refurbishment on their rental properties at the same time

as the installation of ESMs, so that all works can be completed in a period of non-occupancy by a tenant. Undertaking multiple works at the same time can cause VAT liability issues due to the VAT single and multiple supply rules. Where eligible ESMs are installed at the same time as other building works, the supply by the contractor may be either:

- a single supply subject to a single VAT rate (for example, if all ESMs are installed in a newly constructed extension, the whole supply may be standard rated at 20%); or
- a multiple supply, where the individual supplies may be subject to different VAT rates (for example, a newly constructed extension is standard rated at 20%, whereas ESMs fitted in another part of the property may be zero-rated (or reduced rated at 5% from 1 April 2027).

The supply of renting out a domestic dwelling by a landlord is exempt from VAT. Where a landlord makes only VAT exempt supplies, they are not able to recover VAT charged to them on their costs. As the cost cap of £15,000 is a VAT inclusive amount, the actual value of works that may be undertaken will differ due to the potentially different VAT rates applying to the installation of ESMs as explained above.

For example, where the costs are all reduced-rated at 5% VAT, the value of the cost cap will be £14,285.71
(i.e. 100/105 x £15,000). For others, the spend on the works of energy efficiency improvements will be all standard rated at 20%, meaning that the cost cap will be equivalent to £12,500) of works (100/120 x £15,000), so ultimately less money will be attributed to the net costs of green improvements, as part of the cost cap spend is tax.

The full CIOT response is available here: www.tax.org.uk/ref1491.

Kate Willis *kwillis@ciot.org.uk*
Jayne Simpson *jsimpson@ciot.org.uk*