

**EXPLANATORY MEMORANDUM TO  
THE VALUE ADDED TAX (HEALTH AND WELFARE) ORDER 2007**

**2007 No. 206**

**1.** 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

**2. Description**

2.1 This Order amends Group 7 (Health and Welfare) of Schedule 9 (Exemptions) to the Value Added Tax Act 1994 (c.23).

2.2 The effect of the Order is to limit exemption for services provided by medical practitioners, dentists (including dental care professionals) and pharmaceutical chemists to those services that consist in the provision of medical care following a ruling by the European Court of Justice in the case of *Peter d'Ambrumenil and Dispute Resolution Services* (Case C-307/01).

2.3 Articles 3, 4 and 6 implement the required changes in relation to medical practitioners, dentists (including dental care professionals) and pharmaceutical chemists respectively.

2.4 Article 5 retains the original provision in relation to dental technicians.

2.5 The Committee is respectfully referred to the explanatory note to the Order for the specific detail.

**3. Matters of special interest to the Select Committee on Statutory Instruments**

The Order is subject to the affirmative resolution procedure.

**4. Legislative Background**

4.1 This Order has been made by the Treasury in exercise of its powers under section 31(2) of the Value Added Tax Act 1994.

4.2 Section 31(2) provides that the Treasury may by order vary Schedule 9 by adding to or deleting from it any description of supply or by varying any description of supply for the time being specified in it, and the Schedule may be varied so as to describe a supply of goods by reference to the use which has been

made of them or to other matters unrelated to the characteristics of the goods themselves.

## **5. Extent**

This instrument applies to all of the United Kingdom.

## **6. European Convention on Human Rights**

Dawn Primarolo, Paymaster General, has made the following statement regarding Human Rights:

In my view the provisions of the Value Added Tax (Health and Welfare) Order 2007 are compatible with the Convention rights.

## **7. Policy background**

7.1 It has historically been the UK's position that, where a registered health professional provides services using his professional training and knowledge, those services, with certain limited and specified exceptions, are exempt from VAT under Group 7 (Health and Welfare) of Schedule 9 (Exemptions) to the Value Added Tax Act 1994. The UK believed that this correctly implemented Article 13(A)(1)(c) of the EU 6<sup>th</sup> VAT Directive (now Article 132(1)(c) of the principal VAT Directive) which provides for exemption from VAT for 'the provision of medical care in the exercise of the medical and paramedical professions as defined by the Member State concerned'.

7.2 However, in Case C-307/01, the European Court of Justice defined the term *medical care* for the purposes of Article 13(A)(1)(c) as services having a therapeutic nature and examinations or other medical interventions of a preventative nature for persons not suffering from any disease or health disorder. As such, it ruled that exemption is limited to those services intended principally to protect (including maintain or restore) the health of individuals. Therefore, services which are *not* intended principally to protect the health of individuals should be taxable. Liability is therefore dependent on the principal purpose for which the supply is made and, as such, the current UK exemption for services provided by registered health professionals is too wide.

7.3 The Value Added Tax (Health and Welfare) Order 2007 will come into force on 1 May 2007. It makes it explicit that services provided by registered health professionals can only qualify for exemption from VAT where the principal purpose of the service is intended principally to protect (including maintain or restore) the health of individuals.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached at Annex A.

8.2 The impact on the public sector is estimated to be around £5m.

## **9. Contact**

Jane Hyde at HM Revenue and Customs Tel: 0121 697 4010 or e-mail: [jane.hyde@hmrc.gsi.gov.uk](mailto:jane.hyde@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.

# **Regulatory Impact Assessment**

## **VAT: Liability treatment of medical services**

### **1. Title**

This is a Regulatory Impact Assessment (RIA) on amendments to the VAT exemption for the supply of medical services provided by registered health professionals, following the decision of the European Court of Justice (ECJ) in the case of Dr Peter D'Ambrumenil (C-307/01).

### **2. Purpose and intended effect of the measure**

#### ***Background***

Article 132(1)(c) of the Principle VAT Directive (formerly Article 13(A)(1)(c) of the EU 6<sup>th</sup> VAT Directive) exempts from VAT *'the provision of medical care in the exercise of the medical and paramedical profession as defined by the member state concerned.'*

Historically, HM Revenue & Customs' (HMRC) view has been that this provided for exemption in all circumstances where a registered health professional provides services using his professional training and knowledge. This was regardless of the purposes for which the service was commissioned or sought, and whether the service was commissioned by a patient or a third party. This position is reflected in how the UK transposed this exemption into domestic VAT law.

Hence, UK law - under Items (1), (2)(a), (b) and (3) of Group 7 of Schedule 9 to the VAT Act 1994 – currently exempts the *supply of services* by persons registered or enrolled under one of a number of listed professional health registers.

The scope of this exemption was restricted slightly in 1996 and 2001, when services that were predominantly legal in nature and paternity testing respectively, were excluded from the exemption, following domestic and European litigation. However, in all other respects, the application of this exemption in the UK has remained largely unchanged.

On 20 November 2003, the ECJ issued its decision in the case of Dr Peter d'Ambrumenil and Dispute Resolution Services (C-307/01) on the scope of the exemption provided in Article 13(A)(1)(c) of the 6<sup>th</sup> VAT Directive. As the scope of VAT exemptions are agreed at European level, and set down in EU VAT law, the UK is required to implement this decision in how it applies the exemption for services provided by health professionals.

The Court defined the term *medical care* for the purposes of Article 13(A)(1)(c) and confirmed that exemption is not restricted to therapeutic care in relation to the treatment of illness, disease or health disorder, and that medical examinations or other medical interventions that are of a preventative nature for persons not suffering from any disease

or health disorder are covered by the exemption. However, it ruled that exemption should be restricted to **services intended principally to protect (including maintain or restore) the health of individuals**. Those services which are *not* intended principally to protect the health of individuals, are not within the scope of the exemption. Essentially, therefore, liability is dependent on the purpose for which the supply is made – referred to as the ‘purpose test’.

The UK is consequently required to restrict the scope of exemption for medical services, so as to exclude any services which are not ‘medical care’ for the purposes of the exemption at Article 132(1)(c) of the Principle VAT Directive in that they are not provided or commissioned principally to protect the health of individuals. However, the VAT exemption for medical care or treatment provided or commissioned for the purposes of protecting the health of individuals – **which includes all health care and treatment provided to a patient within the normal professional-patient relationship** – remains unaffected by this decision.

### **Objective**

The objective of the measure is to limit the scope of the exemption under Items 1, 2(a), 2(b) and 3 of Schedule 9, Group 7 of the VAT Act 1994 to medical care, in accordance with the ECJ ruling.

The liability of some services provided by registered health professionals will change as a result, but the VAT treatment of health care and treatment, and of all NHS work, will not be affected by this amendment.

The term ‘medical care’ will not be defined in UK law, but detailed guidance will be issued by HMRC on its application.

The change takes effect from 1 May 2007.

### ***Rationale for Government intervention***

The UK must implement the changes into UK VAT law and its administration to comply with EU law following the ruling in the ECJ case referred to above.

### **3. Consultation**

HMRC issued a formal consultation in September 2005 with regard to those health professionals covered by Item 1 of Schedule 9, Group 7 of the VAT Act 1994. Respondents included both providers and recipients of health services affected, and, in summary, key points were identified as follows:

The changes are most likely to impact upon:

- certain commercial, non-NHS activity voluntarily undertaken by GP practices, doctors and consultants outside their core NHS contractual responsibilities for medical care and treatment;
- the legal profession, employers and some public bodies as recipients of affected services.

The responses illustrated the dual nature of some health service supplies and the potential difficulties in determining the 'principal purpose', although many stressed the healthcare element. Hence, there was a keen desire from the majority of respondents for clear, detailed guidance to ensure a consistent application of liability across the sector.

It was suggested that some affected suppliers might seek to restructure their business in an attempt to fall below the VAT registration threshold; or alternatively may cease to offer, or reduce the level of services offered in the affected areas. However, no detailed evidence was presented on this point.

Concerns were expressed that a lengthy lead-in period was essential to enable detailed guidance to be produced and provide sufficient time for health professionals (many of whom were unfamiliar with the basics of VAT) to become familiar with it, implement system changes and register for VAT as appropriate. HMRC announced in Business Brief 04/06 that implementation would be deferred and would not take place on 1 April 2006.

A more detailed summary of responses can be found at Appendix A.

In addition, HMRC has also held a number of informal discussions with representative bodies affected by all Items of Group 7 subject to amendment as follows:

- a) The British Medical Association (BMA) - to discuss in particular the nature of services rendered by doctors/consultants on a private basis. HMRC confirmed that all health services provided under the GMS (General Medical Services) contract and all medical care and treatment within the traditional professional-patient relationship, will remain exempt.
- b) The British Dental Association (BDA) were concerned to ensure consistency in approach across the UK and with the medical professions. HMRC have confirmed that services provided under the GDS (General Dental Services) contract and all dental care and treatment within the traditional dentist-patient relationship will remain exempt from VAT. However, advisory services provided by a small number of dentists to Primary Care Trusts on a self-employed basis will become taxable as a result of the changes.
- c) The Pharmaceutical Services Negotiating Committee (for England & Wales) - HMRC have confirmed that essential, advanced and enhanced services provided under the recently introduced framework for community pharmacy services in England & Wales will retain their current liability (exempt, zero or standard-rated as appropriate) and are not affected by this measure. Although pharmacists provide some services outside of this

contract, with the exception of the very occasional report for court purposes, again, no services were identified which are affected by implementation of this measure.

d) The Scottish Pharmaceutical General Council (for Scotland) who are in the process of implementing a framework for community pharmacy services in Scotland which will come into effect fully on 1 April 2007. Whilst absolute assurance cannot be provided until the framework has been finalised, indications are that implementation of this measure will again have minimal, if any impact on this sector.

Note - Northern Ireland have yet to implement a framework, and liaison with HMRC will take place as necessary once implementation is in process.

e) The Association of British Insurers – to discuss any potential impact on the insurance sector. HMRC have confirmed that insurance-related medical services relating to the setting up of contracts or handling of claims will remain exempt from VAT pending legislative amendment of the exemption for insurance services which is currently on hold as a result of an EU review into VAT and Financial Services. However, medical services relating to the valuing of insurance policies for tax purposes will become liable to VAT at 17.5% as a result of this measure.

#### **4. Options and analysis**

1. *Do nothing* - no compliance costs would arise but this would generate inequity of approach as some bodies continue to apply UK law whilst others opt to apply the ECJ ruling, which has direct effect in the UK. It would also result in infringement proceedings being taken against the UK for failure to implement the decision of the ECJ.
2. *Amend UK VAT law and issue detailed guidance* - UK law would be amended so as to limit exemption, consistent with the ECJ decision. The term 'medical care' would not be defined in law but detailed guidance would be provided on its application. This will necessarily involve additional VAT costs for some customers and compliance costs as detailed below, but once the relevant VAT borderlines are established, it should provide legal certainty, and greater clarity and consistency of approach for suppliers and taxpayers.

#### **5. Recommendation**

Amending the legislation, in line with the ECJ decision and European agreements is consistent with our EU obligations, and should have no impact upon the VAT exempt status of all supplies of medical or dental care and treatment provided to patients by registered health professionals.

It will, however, provide legal certainty and consistency in respect of other services provided by health professionals. Detailed guidance will provide the foundation for a consistent approach in applying the decision, avoids the need for case-by-case decisions

by suppliers, and is consistent with the desire expressed widely during HMRC's consultation on this measure.

Option 2 is therefore the recommended option.

## **6. Costs and benefits**

### ***Business sectors/people affected***

The services most affected by the changes are witness testimony/reports for litigation, compensation or benefit purposes; reports/medicals for the purpose of providing certain fitness certificates; and some occupational health services. The measure will therefore impact as follows:

#### *Health providers:*

The increase in taxation will mostly affect GPs, doctors, and consultants who are already VAT registered or whose income from affected services takes them over the VAT registration threshold. This includes dispensing GPs who registered for VAT from 1 April 2006 a result of Department of Health changes in funding procedures for dispensed drugs – HMRC Information Sheet 03/06 refers. In addition, a small number of dentists who act in an advisory capacity to Primary Care Trusts may also be affected.

In all, it is tentatively estimated that around 650 health professionals (GPs, doctors and consultants) will have to register for VAT as a result of the current changes, although the margin of uncertainty around this estimate is wide. Also, we have assumed that these health professionals will choose to register as individuals; if some GPs choose to register as group practices, the actual number of registrations will be lower than the number of individuals involved, and the administrative burdens will also be lower than those estimated here.

It is also estimated that around 3,700 health professionals are already registered for VAT either because they have done so in the course of their everyday activities or as a result of other, unrelated changes (see changes re dispensing of drugs above). While these medical practitioners will obviously not have to register for VAT again, they will have to adapt to the changes introduced by the implementation of the ECJ ruling if they provide any of the affected services.

#### *Recipients of health services:*

Private individuals who directly commission affected services will be unable to reclaim the VAT charged. However, it is believed that most of the affected services will be commissioned by the following bodies:

The legal profession will be particularly affected by the measure as recipients of affected



health services. The requirement to charge VAT on services where the principal purpose relates to litigation or compensation claims could result in a reduction of the availability of expert witnesses if health providers seek to avoid having to register for VAT. However, as fully taxable bodies, they will be able to recover any VAT charged.

Companies and non-departmental public bodies who engage external contractors to undertake Health & Safety assessments and medicals/reports for pre-employment, litigation or other reasons will incur additional VAT. If the company/public body is engaged in exempt activities, they will be unable to reclaim all or part of the additional VAT incurred, depending on their partial exemption position.

Government departments, NHS bodies and local authorities will be able to recover additional tax charged on most, albeit not all, of the affected services under Sections 41 and 33 of the VAT Act 1994.

There may also be a small impact on charities that use medical professionals to give lectures on the latest medical advancements, but most health-based educational services will remain exempt.

### ***Administrative burdens and compliance costs***

Extending VAT to certain services provided by registered health professionals will impose some new compliance costs on those health professionals who are not currently VAT registered. In the first instance, these professionals will need to consider their turnover and if the value of *all* their *taxable* supplies is over the registration threshold, they will need to register for VAT. They will then have to account for VAT on all taxable supplies, but will be able to reclaim VAT on any purchases and expenses in relation to taxable supplies in accordance with the normal VAT recovery rules and in particular, the partial exemption regulations.

Health professionals who are already VAT registered and who provide any of the affected services will need to update their systems to ensure that they account for VAT on those services which become taxable.

It is estimated tentatively that around 650 health professionals will have to register for VAT as a result of implementing the ECJ's ruling, and that around 3,700 will already be registered for VAT and will have to adapt to the new VAT rules.

In Standard Cost Methodology terms (and based on the information within the Standard Cost Model), we estimate that the total extra administrative burden in the first year after the implementation of the change will be around £550,000 and around £535,000 in the second year and thereafter. The breakdown for these totals is given below:

Administrative obligation	Additional administrative burden impact, first year.	Additional administrative burden impact, subsequent years.
Register for VAT	+ £15,000	£0
Submit VAT returns	+ £265,000	+ £265,000
Payment of tax and record keeping/retention	+ £15,000	+ £15,000
Issuing invoices	+ £255,000	+ £255,000
<b>Total</b>	<b>+550,000</b>	<b>+535,000</b>

Notes:

- 1) These are tentative estimates, given the uncertainty of the number of registrations involved.
- 2) These are also cautious estimates because, as mentioned above, the true cost could be less if some new registrations by medical practitioners are as groups rather than individuals; if so, costs will be reduced.
- 3) The only extra administrative impact for existing registrations rather than new ones should be from issuing more invoices. The “issuing invoices” estimate assumes that 50% of both new and existing registrations will issue invoices, although it should be noted that this is not an evidenced assumption.
- 4) It is assumed that there is little or no “churn” amongst the new registrations, i.e. moving on and off the VAT register from year to year.

Away from the administrative burdens themselves, this measure will also impose wider compliance costs. Health professionals that have to register for VAT because of the implementation of the ECJ’s ruling will have to familiarise themselves with enough of the entire VAT system, or employ accountancy services to take care of their VAT affairs for them. Those medical practitioners having to register and choosing to do their own VAT accounts may well also incur IT costs if they choose to purchase or upgrade an accounts software package.

Health professionals already registered for VAT and carrying out their own VAT calculations will need to familiarise themselves with the changed liability rules.

First-time familiarisation of the VAT system is assumed to take around 15 hours. Over an estimated 650 new registrations, this is a total one-off cost of around £115,000 in total. For those health professionals already registered for VAT, getting up to speed with the changes introduced by this measure may take around 3 hours; over the estimated 3,700 existing relevant registrations, this equates to a further one-off cost of around £130,000.

In terms of the IT cost, it is assumed that affected health professionals already have

access to IT equipment; it is also assumed that existing VAT registrations already have VAT accounting software (where the VAT accounts are not handled by an external accountant). Any additional cost is therefore derived from extra software requirements for new VAT registrations.

Although the cost of accounting software will vary depending on the needs of individuals, basic accounts packages seem to retail for at most £150 per copy. Cheaper packages are on the market, and affected health professionals may only need to upgrade an existing package to cope with any new VAT accounts rather than buy a whole package from scratch. Based on this, we take the average IT cost to be around £100 per package/upgrade. This equates to around £65,000 in total (as a one-off cost), although this figure is especially tentative.

Implementation will be from 1 May 2007 to give registered health professionals sufficient time to familiarise themselves with the new rules, become VAT registered if necessary, and make appropriate system changes. Some health professionals who currently operate as partnerships with regard to non-NHS activities may also want to consider re-organising their affairs so that their non-NHS income falls below the VAT registration threshold, thus avoiding the need to register and account for VAT.

### ***Summary of effects***

Health professionals who are required to register for VAT as a result of the changes will incur one-off compliance costs in applying for VAT registration and making any necessary system changes, as well as ongoing costs.

Assuming up to 650 health professionals (mostly GPs, doctors and consultants) will have to register for VAT, administrative burden costs (consistent with the Standard Cost Model) are expected to be around £550,000 in the first year and around £535,000 thereafter. In addition to the Standard Cost Model's measurement of costs, there is an estimated one-off total compliance cost of around £310,000.

### ***Exchequer effect***

HMRC estimates that implementing these changes (which will result in some services currently exempt becoming taxable) could raise additional revenue of £5-10 million per annum; although on the balance of probabilities the true effect is likely to be towards the top end of this range. This estimate takes account of a behavioural response to the removal of the VAT exemption from these medical services.

### ***Costs and savings for HMRC***

Processing new VAT registrations (estimated at 650) will be managed on existing

staffing levels and is not expected to result in any significant additional costs.

## **7. Competition assessment and impact on small firms**

The Government has undertaken a competition filter test and concluded that implementing these changes will not have a significant impact on competition in the health sector.

Approximately 650 health professionals, mostly GPs, doctors and consultants are expected to exceed the VAT registration threshold as a result of the changes and be required to register and account for VAT with effect from 1 May 2007. It is expected that these new registrations will be “small firms” (single and partnership practices) and these bodies will incur additional administration costs by way of completing and submitting VAT returns as a result.

## **8. Enforcement, sanctions and monitoring**

Measures to ensure compliance with the changes introduced by this measure will include VAT assurance visits, the deterrent of the existing penalty regime, local knowledge, education and advice, as well as the normal policy assurance process.

This measure is being introduced following formal consultation with health service providers and clients, and informal discussions with the BMA, BDA, and Scottish/English Pharmaceutical representative bodies. The Government will consider any comments from business and individuals about how the change has impacted on them.

## **9. Implementation and Delivery Plan**

The change will be implemented by Treasury Order subject to affirmative resolution and will take effect from 1 May 2007. Public Notice 701/57 Health Professionals has been revised to reflect the new changes, and provides detailed guidance on liability issues for health professionals affected by the changes.

An Information Sheet will also be issued to assist health professionals in working through the process of determining whether and how they should register for VAT. It also advises them to consider whether they are eligible for, and wish to use, the annual accounting or cash accounting schemes available for small businesses.

All health professionals who make taxable supplies as a result of the changes and are already, or become registered for VAT as a result, will be required to charge VAT on all taxable supplies. They will also be able to recover any VAT charged on any related costs to the extent that they relate to their taxable supplies.

Affected health professionals will already be maintaining accounting (purchase and sales) records. However, they will need to ensure that from the date of their registration, these

records comply with HMRC's record keeping requirements. These records will need to be made available to HMRC for verification purposes from time to time.

## **10. Post Implementation review**

A further compliance cost review will take place within 12 to 24 months following implementation.

## **11. Summary**

This is an ECJ imposed measure which the UK has no choice but to implement and will result in some services provided by registered health professionals which are currently exempt, becoming subject to VAT at 17.5%.

## **12. Contact point**

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## **10. Declaration**

I have read the Regulatory impact Assessment and I am satisfied that the benefits justify the costs.

*Dawn Primarolo*

Paymaster General .....

18th January 2006