



## VAT on domestic care supplied by private businesses

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Many Members have been contacted by constituents concerned that they have had to pay VAT on the provision of domestic care supplied to them in their own home. Since the introduction of VAT in this country a distinction has been drawn between the supply of medical care provided by a qualified professionals – which has been exempt from VAT – and domestic care provided commercially – which has been charged VAT at the standard rate. In February 2000 the Government proposed a VAT concession for home care services, alongside changes to be made in the regulations governing the conduct of employment agencies and employment businesses and the rights of work-seekers using them.<sup>1</sup>

In December 2002 the Government announced, as an alternative to this concession, a more comprehensive relief to accompany the statutory regime of regulation of private welfare agencies.<sup>2</sup> Under the *Value Added Tax (Health and Welfare) Order SI 2003/24* – which came into force on 31 January 2003 – all welfare services provided by state-regulated private welfare agencies are exempt from VAT. In the case of commercial domiciliary care agencies, exemption applies to all care services (including routine domestic tasks) provided to elderly, sick or disabled persons, where the recipient of the service cannot perform the task safely or adequately, or without significant pain or discomfort.<sup>3</sup> This note sets out the background to this change.

### Contents

A.	VAT on medical care, domestic care and welfare services	2
B.	EU VAT rules and the treatment of care	4
C.	The VAT treatment of care and employment bureaux	6
D.	VAT exemption for state-regulated private welfare agencies	10

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<sup>1</sup> HM Customs & Excise Business Brief 3/2000, 22 February 2000. This related reform is examined in a second Library standard note: “Employment agencies”, SN/BT/691, 10 February 2005.

<sup>2</sup> The *Care Standards Act 2000* introduced the framework for this statutory regime, which in turn has been amended by the *Health and Social Care (Community Health and Standards) Act 2003*. The Commission for Social Care Inspection (CSCI) took over the regulation of domiciliary care agencies from 1 April 2004.

<sup>3</sup> HM Customs & Excise Business Brief 01/03, 20 January 2003

## A. VAT on medical care, domestic care and welfare services

VAT is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt. All businesses must register for VAT if their annual turnover of taxable goods and/or services is above a given threshold, which is currently £58,000.<sup>4</sup> VAT is charged either at the standard rate - currently 17½% - or the zero rate.<sup>5</sup> VAT is charged on the additional value of each transaction, and is collected at each stage of production and distribution. A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax. It will settle up with HM Customs and Excise for the difference between the two. In the end the cost of the tax is borne by the final consumer.

UK VAT law is consolidated in the *VAT Act (VATA) 1994*. Schedule 8 to the Act sets out those supplies which are zero-rated for VAT; schedule 9 sets out those supplies which are exempt from VAT. It is worth emphasising the difference between supplies which are exempt from VAT, and those that are charged a zero rate. Supplies which are zero-rated are technically taxable, though no actual tax is paid on them. They count as part of the taxable turnover of a business for registration purposes, and VAT charged on inputs related to zero-rated activities can be reclaimed. This is not the case with exempt supplies, which are outside the tax system. Businesses which make exempt supplies do not charge output tax, and cannot reclaim input tax. In effect, a business making exempt supplies has to absorb the VAT charged to it by its suppliers.

Turning to the supply of care, a distinction has been drawn in VAT law between the professional services of a qualified doctor, nurse, midwife or health visitor – which are exempt from VAT – and the supply of domestic care, say by a private concern to someone in their own home – charged VAT at the standard rate. Health and welfare supplies exempt from VAT are listed in Group 7 to Schedule 9 of *VATA 1994*. Under these provisions personal and nursing care – such as bathing, dressing or feeding a patient – provided commercially in the home *may* be exempted from VAT *if* performed or directly supervised by a qualified nurse predominantly to meet the medical needs of the client.<sup>6</sup> However care provided by someone both unsupervised and unqualified would not qualify for VAT-exemption; similarly domestic care services – such as cleaning, cooking and shopping – would not be exempt.

The distinction between medical care provided by health professionals and other forms of care dates back to 1973 when VAT was first introduced.<sup>7</sup> The Paymaster General, Dawn Primarolo, underlined this distinction in answer to a PQ in December 1997, adding that in some situations VAT might not be charged by someone supplying domestic care, if their business was of such a size that they fell below the registration threshold:

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<sup>4</sup> With effect from 1 April 2004 (HM Customs & Excise Budget Notice CE5, 17 March 2004).

<sup>5</sup> A reduced rate of 5% is charged on a small number of supplies under schedule 7A of the *Value Added Tax Act (VATA) 1994*; principally, the supply of domestic fuel and power, the installation of energy saving materials, women's sanitary products, children's car seats and certain types of construction work.

<sup>6</sup> For details see HM Customs & Excise, *Health professionals: VAT Notice 701/57/02*, March 2002 pp 4-7.

<sup>7</sup> The principal provisions relating to VAT were contained in the *Finance Act 1972*; schedule 5 set out those supplies to be exempt from VAT - and group 7 covered supplies related to health.

**Mr. Gibb:** To ask the Chancellor of the Exchequer if he will make a statement on the Government's policy regarding VAT on domiciliary care services.

**Dawn Primarolo:** The policy on the VAT treatment of domiciliary care services depends upon their nature. Where those services constitute medical care or welfare they are exempt from VAT. Domestic services such as laundry, cleaning, etc. do not qualify for VAT relief under any exemption. However, many of these are provided by people below the threshold for VAT and are tax free.<sup>8</sup>

Private care agencies have drawn attention to the fact that – generally speaking – local authorities do not charge VAT on their domestic care services. Usually a local authority's welfare services – domestic care included – would be considered as part of their *non-business* activities, and, as such, exempt from VAT. (Local authorities' *business* activities are treated in exactly the same way as ordinary traders.) As noted above, supplies exempt from VAT are set out in schedule 9 of *VATA 1994*; group 7 covers health and welfare services, and item 9 to this list is the “supply, otherwise than for profit, by a charity ... or a public body of welfare services and of goods supplied in connection with those welfare services.” As a consequence charities providing welfare services on a not-for-profit basis have been entitled to exempt their supplies from VAT as well. Indeed in February 1999 Customs clarified the coverage of ‘welfare services’ provided by charities on a not-for-profit basis to include home help services.<sup>9</sup>

On a separate if related issue, following a VAT tribunal case in May 2001 there were reports in the press that residential care homes would have to charge VAT on their fees.<sup>10</sup> The tribunal held that the nature of care had to be ‘medically or surgically related’ to qualify for exemption under the existing legislation, referring to the provisions in European VAT law governing the VAT base on which VAT law across all Member States is based. Although the decision was upheld by the High Court, the Government introduced an Order in March 2002 ensuring that the provision of nursing care in residential homes *continued* to be exempt from VAT.<sup>11</sup> Among the changes made by this legislation, the list of institutions entitled to supply VAT-exempt welfare services – set out in item 9 to group 7 of schedule 9 of *VATA 1994* – was amended to read (*emphasis added*): the “supply, otherwise than for profit, by a charity, a *state-regulated private welfare institution*, or a public body of welfare services and of goods supplied in connection with those welfare services.”<sup>12</sup>

On the question of local authorities providing care, it is worth noting that if a local authority supplies domestic care by contracting this work out to a private company, it would not incur

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<sup>8</sup> HC Deb 9 December 1997 c 508W

<sup>9</sup> The term is taken to cover “routine domestic tasks ... when an assessment has been carried out which shows that there is a risk to recipients’ physical or mental health or welfare because they are unable to carry out the tasks safely or adequately, or without significant pain or discomfort” (HC Deb 1 February 1999 c 414W). For guidance see, *Charities - liability of routine domestic tasks: VAT Information Sheet 6/99*, March 1999.

<sup>10</sup> *Kingscrest Associates Ltd & Montecello Ltd (VTD 17244)*, 14 May 2001

<sup>11</sup> *The Value Added Tax (Health and Welfare) Order SI 2002/762*

<sup>12</sup> HM Customs & Excise press notice PR 21/02, 20 March 2002. The issue is discussed at more length in “VAT on residential care”, Library standard note SN/BT/1108, 4 November 2004.

VAT on this supply. Special provision is included in section 33 of *VATA 1994*, which allows local authorities to reclaim VAT they have paid in the course of their non-business activities; the rationale for this provision was given in answer to a PQ:

**Ms Roseanna Cunningham:** To ask the Chancellor of the Exchequer if he will make a statement on the criteria his Department applies in respect of the operation of the Value Added Tax Act 1994, section 33.

**Dawn Primarolo :** The chief criteria which apply to the operation of section 33 of the Value Added Tax Act 1994 are that VAT should not fall as a burden on local taxation, and that local authorities should not bear tax on activities they are specifically required by statute to undertake.<sup>13</sup>

Many people have felt that the treatment of domestic care is anomalous, particularly those forced to purchase care from a private company by their local authority's decision to withdraw it from them. Clearly there have been concerns that extending the VAT exemption of welfare in this fashion might be considered unfair - what other services should be counted if this were the case? - and could be costly. In addition, the fact that in the past private agencies have been able to supply domestic care unregulated by the state has meant that this move would have contravened European VAT law. The next section of this note discusses this issue.

## **B. EU VAT rules and the treatment of care**

The sixth VAT directive (77/388/EEC) was agreed in May 1977, and establishes the base of VAT in all Member States. Article 13 of the directive lists those supplies which should be exempt from VAT including – in Article 13A – “certain activities that are in the public interest.” Three items on this list are pertinent to the VAT treatment of medical and domestic care:

- 1(b): “hospital and medical care and closely related activities undertaken by bodies governed by public law or, under social conditions comparable to those applicable to bodies governed by public law, by hospitals, centres for medical treatment or diagnosis and other duly recognised establishments of a similar nature.”
- 1(c): “the provision of medical care in the exercise of the medical and paramedical professions as defined in the Member State concerned.”
- 1(g): “the supply of services and of goods closely linked to welfare and social security work, including those supplied by old people's homes, by bodies governed by public law or by other organisations recognised as charitable by the Member State concerned.”

As a consequence of these provisions Member States may exempt from VAT welfare supplies provided by local authorities and charities, but not similar supplies made by private profit-making businesses which are not governed by public law.

Some commentators have suggested that the supply of domestic care by private businesses should be charged a zero rate of VAT. Unfortunately this would also contravene EU VAT law. Agreement on harmonising the rates of VAT - rather than the VAT base - was reached in June 1991 and incorporated in directive 92/77/EEC of 19 October 1992, which amended the sixth VAT directive accordingly. In brief, all Member States:

- must apply a standard VAT rate of 15% or more from 1 January 1993;
- have the option of applying one or two reduced rates, no lower than 5% to certain specified goods, as listed in Annex H of the directive;
- are able to continue charging any lower rates, including zero rates, that had been in place on 1 January 1991 for the duration of the “transitional period”, assuming these rates were in accordance with Community law.

Member States may only continue to charge zero rates *in place* on 1 January 1991. No Member State can introduce a new zero rate or reintroduce a zero rate once it has been abolished. Initially it was thought that the “transitional period” would come to an end on 31 December 1996, when a definitive VAT regime came into force. However, there has been considerable delay in the next stage of VAT harmonisation. No legislation has been proposed for a definitive system as yet, and without unanimous agreement on any future changes in European VAT law, these arrangements may continue indefinitely.

As a consequence the UK cannot introduce *any* new zero rates, a point which was made in answer to a PQ in June 1995 proposing an extension of zero-rating to cover domestic care:

**Mr Hanson:** To ask the Chancellor of the Exchequer what plans he has to zero rate home care services for VAT purposes where the home care is provided by non-medically qualify personnel in the private sector.

**Mr Heathcoat-Amory:** None. Any extension of the existing zero rates would be contrary to the EC sixth VAT directive.<sup>14</sup>

Clearly an alternative to zero-rating this supply would be to charge a reduced rate – between 5% and 15%; as noted, Member States may, if they choose, charge a reduced rate on any supply listed in Annex H to the sixth VAT directive – though domestic care is *not* on this list.

In October 1999 the European Council agreed to an amendment to these rules to give Member States the *option*, should they so wish, to apply a reduced VAT rate to certain ‘labour-intensive services’, as a means to reduce unemployment.<sup>15</sup> Member States may choose up to three items from a list of supplies – set out in Annex K to the sixth directive – to apply a VAT rate as low as 5% until 31 December 2005.<sup>16</sup> One of the items in this list is “domestic care services (eg, home help and care of the young, elderly, sick or disabled).” Several Member

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<sup>13</sup> HC Deb 26 June 1997 c 590W

<sup>14</sup> HC Deb 14 June 1995 cc 515-516W

<sup>15</sup> Directive 1999/85/EC [OJ L 28 October 1999 277/34-36]

<sup>16</sup> The lifetime of the scheme has been extended twice. Initially it was to run for three years only.

States have elected to make use of the experimental reduced rate scheme,<sup>17</sup> but the UK is *not* one of them.<sup>18</sup> In July 2003 the European Commission published proposals for simplifying the rules regarding reduced VAT rates<sup>19</sup> – although they have proved highly controversial and no changes have been agreed as yet.<sup>20</sup>

### C. The VAT treatment of care and employment bureaux

Often those provided with care in their own home have had their nurse or carer placed with them by an employment bureau. This has added a further complexity to the VAT treatment of their care. A key question to consider is whether the bureau has acted as a principal (acting as a carer/nurse's employer, and providing their services to a client), or an agent (placing the carer/nurse with a client, who has a contract with that individual for the supply of care). If the bureau acts as a principal, they are making a *single* supply for which the consideration is the whole of the charge to the client. If they act as an agent, two *separate* supplies being made: the bureau's services in arranging and administering the care, for which the bureau levies a commission, fee or charge; and, the carer or nurse's services in carrying out the care for the client, for which they would charge a fee.<sup>21</sup> In the past the bureau's commission for arranging the care would be standard-rated; the carer's fee would either be standard-rated (if they provided domestic care), or exempt (if they provided medical care).<sup>22</sup>

A word on terminology may be helpful at this point. In ordinary conversation the term 'employment agencies' is often used to cover all organisations providing temporary staff, whether they do so as principal or agent. This is misleading. Under the *Employment Agencies Act 1973*, the legislation which regulates this sector, employment **agencies** are those which supply workers to work for companies on a permanent basis as employees of that company (ie, acting as an agent). Employment **businesses** supply workers, usually on a temporary basis, who are employed by the employment business to work in that company (ie, acting as a principal). To avoid confusion, this note uses the term 'employment bureaux' to cover both, reserving the terms 'employment agency' and 'employment business' for their correct statutory use.<sup>23</sup>

There is an important incentive for employment bureaux to provide their temporary staff on an 'agent' basis, in that it allows them to avoid assuming the responsibilities of being an

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<sup>17</sup> HM Customs & Excise explanatory memorandum, 25 January 2000

<sup>18</sup> HC Deb 17 December 2001 c 26W

<sup>19</sup> COM (2003) 397 final, 23 July 2003

<sup>20</sup> For details see, "VAT reduced rates: recent EU proposals", Library standard note SN/BT/2683, 21 December 2004.

<sup>21</sup> This fee would not form part of the employment bureau's outputs; rather such fees are disbursements which the bureau makes to the carer or nurse on the client's behalf.

<sup>22</sup> *Agencies providing nurses and nursing auxiliaries: VAT Notice 710/2/83*, 1 July 1983

<sup>23</sup> This is in line with the terminology used in the Government's consultation document on the private recruitment agency, discussed below.

employer.<sup>24</sup> Indeed a significant number of employment bureaux providing care workers for elderly people have done this, with the result that the client pays the agency a fee for arranging the carer's placement, and pays the carer's wages direct to the carer, leaving the carer to be responsible for paying tax and national insurance contributions as a self employed person. The VAT treatment of domestic care has given bureaux a second incentive to act this way. By arranging for the carer to be paid directly by the client, bureaux have had to charge VAT only on the fee they charge for bringing carer and client together. Turning to the individual carer, their business turnover is often too small to exceed the annual VAT registration threshold, with the result that they would not charge the client any VAT.<sup>25</sup> If the employment bureau had been required to be the carer's direct employer, they would have been obliged to charge VAT on the entire value of the domestic care services they supplied.

In May 1999 the Government published a consultation document on draft regulations designed to clarify and reform the law on the conduct of employment agencies and employment businesses.<sup>26</sup> One proposal was to amend the law to require temporary staff hire to be conducted on the basis of a contractual relationship between the bureau and the work-seeker, to make the bureau responsible for giving temporary workers paid holidays and ensuring that they receive the national minimum wage.<sup>27</sup> Employment bureaux, carers and those being cared for all expressed concerns about the consequences this would have for VAT treatment of this supply.<sup>28</sup>

The consultation paper included some discussion of the VAT implications of changing the rules regarding temporary staff hire, although the specific issue of domestic care was not examined in depth:

Where a temporary worker is supplied on an employment agency basis their wages do not form part of the taxable supply made by the bureau to the hirer with the result that less VAT needs to be paid. Hiring temporary workers on this basis is particularly attractive to employers unable to offset VAT paid as input tax against their own taxable supplies – the sectors where this is the case include financial services, charities, private healthcare and the public, as they cannot reduce the net VAT paid. Some employment bureaux have begun offering the majority of their services on an employment agency footing – even to clients who derive no VAT benefit – as a means of reducing the bureau's responsibilities to the temporary worker being supplied.<sup>29</sup>

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<sup>24</sup> for example, ensuring their staff's employment rights under legislation such as the *National Minimum Wage Act 1995* and the *Working Time Regulations 1998*

<sup>25</sup> This point was made in the PQ on the VAT liability of these supplies quoted above (HC Deb 9 December 1997 c 508W). As mentioned, the registration threshold has been set at £58,000 from 1 April 2004.

<sup>26</sup> Department for Trade and Industry, *Regulation of the Private Recruitment Industry*, May 1999. For more details see, "Employment agencies", Library standard note SN/BT/691, 10 February 2005.

<sup>27</sup> *op.cit.* para 6.5.26

<sup>28</sup> The issue was raised in an adjournment debate by Paul Burstow MP in October 1999 (HC Deb 29 October 1999 cc 1267-1276).

<sup>29</sup> DTI, *Regulation of the Private Recruitment Industry*, May 1999 pp 116-117

In February 2000 the Government published an initial response to the representations it had received, including a proposal for a new extra statutory concession (ESC)<sup>30</sup> regarding the VAT treatment of care provided the sick, elderly or disabled people in their own homes.<sup>31</sup> In brief, it was anticipated that the concession would allow businesses providing home care services to exclude the salary and related costs (national insurance contributions, pension costs etc) of home care workers from the value of their supplies.<sup>32</sup> This was *not* a proposal to exempt the supply of private care from VAT: rather, employment bureaux would only charge VAT in practice on that part of their bill relating to commission costs etc – not on the wages element of the bill – when billing for supply of home care to individuals in their own homes; the VAT liability of care would not be legally changed.

On 1 February 2001, the DTI issued a revised draft of the *Conduct of Employment Agencies and Employment Businesses Regulations*,<sup>33</sup> with the intention that they would come into force by summer 2001. However the consultation exercise threw up further outstanding issues and a second draft was issued in July 2002. At this time the DTI suggested the revised regulations might come into effect in the first half of 2003,<sup>34</sup> though the final form of these rules were not laid until December that year.<sup>35</sup> The new rules came into force on 6 April 2004.<sup>36</sup> An updated regulatory impact assessment (RIA) of the regulations, published when they were laid before the House, sets out the main changes as follows (*emphasis added*):

- a) ensuring users are clear on the terms, which apply at any point in their relationship with an agency or employment business;
- b) clarifying the steps to be taken by agencies and employment businesses to establish the suitability of those supplied, to check qualifications where these must be held, and to communicate this information;
- c) *ensuring (with certain limited exception) that the supply of temporary staff is conducted on an employment business basis;*
- d) ending certain practices designed to deter hirers from dealing with other suppliers and limiting the circumstances when fees may be charged if a hirer wishes to engage direct a temp formerly hired from an employment business;
- e) allowing some publications to charge work-seekers for job vacancy information subject to certain safeguards;

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<sup>30</sup> “Extra-Statutory Concessions (ESCs) are remissions of revenue that allow relief in specific sets of circumstances to all businesses falling within the relevant conditions. They are authorised when strict application of the law would create a disadvantage or the effect would not be the one intended. (HM Customs & Excise, *Extra-statutory concessions: Customs Notice 48*, March 2002 para 1.2).

<sup>31</sup> DTI press notice P/2000/78, 21 February 2000

<sup>32</sup> HM Customs & Excise Business Brief 3/2000, 22 February 2000. Comments on Customs’ draft text of this concession – which was put on their internet site for a short time – were invited up to 9 March 2001.

<sup>33</sup> DTI press notice P/2001/56, 1 February 2001

<sup>34</sup> HC Deb 23 July 2002 c 949W; DTI press notice P/2002/486, 23 July 2002

<sup>35</sup> The *Conduct of Employment Agencies and Employment Business Regulations* SI 2003/3319. The Order was debated by the Second Standing Committee on Delegated Legislation on 15 December 2003.

<sup>36</sup> DTI press notice, *New protections for temporary workers take effect*, 5 April 2004. The regulations and associated documentation are available at: <http://www.dti.gov.uk/er/agency/newregs.htm>



- f) removing out-dated regulations which either restrict labour market flexibility or where it appears users are able to protect their own interests.<sup>37</sup>

This assessment discussed the VAT implications of the new rules for those hiring staff:

On the whole, hirers will face lower costs except for one group: those unable to offset VAT payments against their own taxable supplies. Hirers that currently take temporary staff supplied on an agency basis will have to pay more VAT when temps are supplied on an employment business basis, or move to employing workers direct perhaps paying the agency an initial recruitment fee. Most hirers are able to offset VAT payments against their own taxable supplies, so there will be no effect. Those unable to do this include banks, charities and private individuals. Of these, the only significant users of temps are financial institutions. This restores the situation to that pertaining before a High Court judgment in 1995 created an incentive to supply on this basis.<sup>38</sup> The proposal does not therefore add to the *intended* cost of existing regulations.

The only addition to compliance costs is the additional VAT payments. Detailed information on the number of hirers taking advantage of this means of VAT avoidance and the level of labour costs is not available. Assuming 2½% of temps are in such arrangements, average temp wages<sup>39</sup> and that the hirer is not eligible for the VAT concession, the current savings to hirers in non-payment of VAT could be about £38 million per year.<sup>40</sup> The payment of VAT would represent a significant increase in labour costs for hirers, but we do not have an estimate of the proportion that would be unable to offset VAT payments. Hirers could reduce this by using permanent staff or by recruiting temporary staff direct if that is cheaper than using services supplied by an employment business. As hirers can change their behaviour, the costs to hirers (and extra revenue to the Exchequer) will be considerably less than the amount not paid in VAT at the moment. Therefore where hirers have been using temps as a way of reducing costs (at the expense of the Exchequer) rather than the requirement to have flexibility, it is likely to lead to a loss of business for some operators.

HM Customs & Excise announced on 22 February 2000 their intention to introduce a concession covering those in need who buy care in their own home. This means that

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<sup>37</sup> DTI, *Revision of the regulations covering the private recruitment industry – regulatory impact assessment*, November 2003 para 6

<sup>38</sup> (*C&E Comrs v Reed Personnel Services Ltd QB [1995]* reported in *Simon's Tax Intelligence* 9 March 1995 pp 412-3 and "Law report: VAT liability depends on the facts", *Times*, 13 April 1995. The Reed employment bureau provided temporary nurses to hospitals. Customs contended that the bureau was providing nursing services (an exempt supply), rather than nurses who in turn supplied their services to the hospitals (ie, only providing administrative services as agent) – noting the terms of the contracts agreed between Reed, its temporary staff and the client hospitals. The Court found for Reed, stating that the contractual arrangements between the parties were inconclusive as to the nature of the supply being made, and as a consequence this question had to be judged from the facts of the case as a whole.)

<sup>39</sup> £230 per week, according to the LFS (Spring 2001, UK)

<sup>40</sup> = 570,000 x 0.025 x £258 x 1.128 x 52 weeks x 17.5% (based on average wages for agency temps in the LFS and allowing 12.8% for employers National Insurance Contributions - 2003/04 rate)

the VAT burden on those least able to look after themselves is not increased as a result of these changes.<sup>41</sup>

During this extended consultation process the Government confirmed that the ESC for home care services would be introduced once the revised regulations on the private recruitment industry were laid before Parliament.<sup>42</sup> As it transpired the Government's announcement on 19 December 2002 that it would extend the VAT exemption for welfare services to those services provided by state-regulated private welfare agencies obviated the need for this concession.<sup>43</sup> As the DTI's RIA goes on to note, "HM C&E have amended the VAT legislation so that supplies by welfare agencies (for example, domiciliary care, nursing and foster agencies) were exempt from VAT with effect from 31 January 2003."<sup>44</sup>

An associated development to the reform concerning employment bureau has been the proposed withdrawal of the 'staff hire concession' – which had been expected to occur when the new regulations came into effect.<sup>45</sup> In the past this concession has enabled businesses providing staff as wardens and managers of sheltered accommodation to mitigate their VAT bill. Strictly speaking the issue is separate to the matter of domestic care; it is discussed at length in another standard note.<sup>46</sup>

#### **D. VAT exemption for state-regulated private welfare agencies**

On 30 December 2002 the Government confirmed that it would introduce legislation to exempt from VAT welfare services provided by state-regulated private welfare agencies. Details were given in a press notice, from which the following is taken:

The Government will abolish VAT on care in the home, cutting the price of essential domiciliary care for many of the 60,000 people who buy these services. In a move announced by John Healey, Economic Secretary to the Treasury and Minister for Customs and Excise, individuals choosing to be cared for at home rather than elsewhere will no longer have to pay VAT on the help they receive.

Welcoming the VAT exemption John Healey said: "The Government is aware of the burden that VAT on home care services can place on sick, elderly and disabled people who rely on such services to enable them to remain in their own homes. I am therefore very pleased to be able to extend VAT exemption to the regulated home care sector. This will enable those who need help to remain independent and recognise the important part that the home care sector plays in doing this. Someone

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<sup>41</sup> *op.cit.* paras 31-33

<sup>42</sup> for example, HC Deb 4 February 2002 c 696W & HC Deb 5 July 2002 cc 627-8W

<sup>43</sup> HC Deb 19 December 2002 c 80WS

<sup>44</sup> *Revision of the regulations covering the private recruitment industry – RIA*, November 2003 para 33

<sup>45</sup> HM Customs & Excise Business Brief 13/99, 18 June 1999. The current position is set out in Business Brief 02/04, 21 January 2004, supplemented by Business Brief 10/04, 19 March 2004.

<sup>46</sup> "VAT on manager and warden services in sheltered accommodation", SN/BT/1225, 5 November 2004

now paying £400 a month for care in their own home could see a reduction of £40 in that bill, as a result of this VAT change.” ... The Government is bringing commercially provided home care services within the scope of the VAT exemption for welfare services. This will mean that providers subject to national care standards will no longer charge VAT on the care that they provide ... This VAT change supports the implementation of care standards and regulatory framework for domiciliary care agencies.<sup>47</sup>

The *Care Standards Act 2000* marked a fundamental change in the regulation of social care and private and voluntary health care services throughout England. The Act set up the National Care Standards Commission, an independent public body, to replace the existing system of inspection by local authority and health authority inspection units authorities, and to extend the scope of regulation to other services not previously registered, to include domiciliary care agencies, fostering agencies and residential family centres.<sup>48</sup>

The NCSC assumed responsibility for the regulation of domiciliary care agencies from 1 April 2003. Regulation applies to all agencies which provide personal care for persons living in their own homes who by reason of illness, infirmity or disability are unable to provide it for themselves without assistance. Agencies providing personal care at any time are required to register. The term ‘agency’ includes all providers of personal domiciliary care services in the private, voluntary and public sectors including the local authority’s own services, and NHS Trusts and supported housing or living schemes where applicable.

On 20 January 2003 Customs confirmed that secondary legislation would be laid before the House, to exempt welfare services supplied by agencies registered with the NCSC (or registered with equivalent bodies in Wales, Scotland and Northern Ireland) from 31 January 2003.<sup>49</sup> Agencies which had yet to be registered by that date would still be entitled to exempt services from VAT, under an extra statutory concession to be made at this time. Full details were given in a business brief, from which the following is taken:

#### **New VAT treatment**

At present, welfare services are only exempt when supplied by public bodies; charities; or establishments, such as residential care homes, that are state-regulated private welfare institutions. The Government will shortly, subject to Parliamentary approval, also exempt from VAT welfare services supplied by state regulated private welfare agencies.

State-regulated private welfare agencies are those agencies that are registered with and/or regulated by: the National Care Standards Commission; the Scottish Commission for the Regulation of Care; the Care Standards Inspectorate for Wales;

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<sup>47</sup> HM Customs & Excise press notice NR 107/02, 30 December 2002

<sup>48</sup> Details on the decision to extend statutory regulation to all domiciliary care agencies is given in *The Care Standards Bill*, Library Research paper 00/52 16 May 2000 pp 39-42.

<sup>49</sup> The *Value Added Tax (Health and Welfare) Order* SI 2003/24 was laid on 9 January, and came into force on 31 January 2003.

or the Northern Ireland Health and Personal Social Services Regulation and Improvement Authority. This may include: domiciliary care agencies; independent fostering agencies; voluntary adoption agencies and nursing agencies. In Scotland, this may also include child care agencies and housing support services. All welfare services provided by state-regulated private welfare agencies will be exempt.

Welfare services are those directly connected with the provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons; or the care and protection of children and young persons. In the case of commercial domiciliary care agencies, exemption will apply to all care services (including routine domestic tasks) provided to elderly, sick or disabled persons, where the recipient of the service cannot perform the task safely or adequately, or without significant pain or discomfort. Home care services provided by local authorities and charities are already exempt from VAT, and are therefore not affected by these changes.

In the case of commercial independent fostering agencies and non-charitable voluntary adoption agencies, exemption will apply to any service directly connected with the care and protection of children and young people. This includes the placement of children with foster carers and the assessment of prospective adopters for domestic and inter-country adoption. Any allowances received by an agency for the care of a child will also be exempt from VAT.

There will be no change to the liability of services provided by charitable fostering or adoption agencies. Welfare services supplied by these charitable providers are already exempt from VAT. Care services provided by registered nurses are already exempt from VAT under separate provisions. This change will not therefore alter the VAT treatment of care services provided by agencies providing nursing services.

### **Arrangement services**

Some businesses, such as employment agencies, do not provide welfare services themselves, but make arrangements for the provision of welfare services by a third party (such as a self-employed home care provider). The VAT liability of a service of making arrangements for welfare provision is not affected by these changes, and VAT will continue to be chargeable on arrangement and introduction fees or commissions charged by businesses that do not themselves supply welfare services.

### **Timing**

For those agencies already registered with, and/or regulated by, the appropriate regulatory body, the change will take effect when the *Value Added Tax (Health and Welfare) Order 2003* is approved (expected to be 31 January 2003). For other agencies, statutory exemption will take effect from the first date on which they are registered with, and/or regulated by, the appropriate regulatory body.

However, any agency that is not yet registered or regulated, either because the regulations providing for the mechanics of such registration or regulation are not yet

in force, or because its application for registration is being processed, may exempt its welfare services from 31 January 2003 under the VAT concession ...<sup>50</sup>

### **Welfare services and VAT registration**

We anticipate that as a result of the changes announced in this Business Brief, many VAT registered businesses that are, or will be, required to register with the regulatory body and to implement the relevant care standards, will no longer have to remain VAT registered. Any state-regulated welfare agency that wishes to remain VAT registered will be required to demonstrate that, in addition to its exempt welfare services, it is also making, or intends to make, taxable supplies.<sup>51</sup>

As noted above, in March 2002 the Government introduced secondary legislation – the *Value Added Tax (Health and Welfare) Order SI 2002/762* – to ensure that the provision of nursing care in residential homes continued to be exempt from VAT. The Order made a number of changes to the wording of the provisions in schedule 9 of *VATA 1994* covering health care; in particular the list of institutions entitled to supply VAT-exempt welfare services – set out in item 9 to group 7 of schedule 9 – was amended to read: the “supply, otherwise than for profit, by a charity, a state-regulated private welfare institution, or a public body of welfare services and of goods supplied in connection with those welfare services.” Under the *Value Added Tax (Health and Welfare) Order SI 2003/24*, this list has been amended a second time, to extend this exemption to all welfare services provided by state-regulated private welfare agencies.<sup>52</sup>

A written answer in March 2003 summarised these changes as follows:

**David Davis:** To ask the Chancellor of the Exchequer (1) what notice was given of changes to VAT exemption for welfare services; (2) what measures he has introduced to compensate private welfare agencies for the loss of input VAT recovery as a result of changes to VAT exemption; (3) what plans he has to treat the provision of welfare services as being zero rated for VAT purposes rather than exempt.

**John Healey:** The Government's introduction of VAT exemption for welfare services provided by state-regulated private welfare agencies means that the 60,000 sick, elderly or disabled people who pay for home care services will no longer have to pay VAT on these services and we estimate that they could see a reduction in costs of up to 13 per cent.

I announced that this exemption would be available from 31 January 2003 in a written Ministerial statement on 19 December 2002, Official Report, column 80WS. Independent fostering agencies, whose supplies are to local authorities, may choose to postpone changing the VAT treatment of their supplies until 1 April while they make the contractual and financial arrangements that are necessary for them to implement

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<sup>50</sup> The text of this concession is published in this business brief, but is not reproduced here.

<sup>51</sup> HM Customs & Excise Business Brief 01/03, 20 January 2003

<sup>52</sup> Item 9 to Group 7 now reads, the “supply, otherwise than for profit, by a charity, a state-regulated private welfare institution *or agency*, or a public body of welfare services and of goods supplied in connection with those welfare services” (*emphasis added*).

the change.<sup>53</sup> Other commercial welfare agencies are required to implement the change when they become state-regulated, the earliest date for which is 1 April 2003.

It is a fundamental principle of the VAT system that businesses may only recover VAT relating to taxable supplies. Commercial providers of VAT-exempt services will take a range of commercial factors, including overheads such as irrecoverable VAT, into account when setting their prices.

There are no plans to introduce a zero rate of VAT for commercially provided welfare services, since we are prevented from doing so by long-standing formal agreements with our European Union partners.<sup>54</sup>

In March 2005 Customs announced a change in its policy concerning the date from which commercial providers of welfare services are 'state-regulated' and thereby required to exempt their services. These businesses may charge VAT until they are registered and approved by the appropriate care standards regulatory body, rather than until the date they apply to register with the appropriate body.<sup>55</sup> As a consequence welfare providers will not be required to exempt welfare services during the period of time in which this registration application is being considered and processed. Full details are given in a Customs' business brief.<sup>56</sup>

Finally, as mentioned at the start of this note, the National Care Standards Commission assumed responsibility for regulating domiciliary care agencies in England from 1 April 2003.<sup>57</sup> Full details of the Commission's work is available on its site.<sup>58</sup>

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<sup>53</sup> [This concession for independent foster agencies was confirmed in HM Customs & Excise Business Brief 03/2003, 28 March 2003.]

<sup>54</sup> HC Deb 26 March 2003 cc 254-5W

<sup>55</sup> HC Deb 3 March 2005 c 93WS; HM Customs & Excise press notice, *Customs Minister announces VAT flexibility for private welfare agencies*, 3 March 2005.

<sup>56</sup> HM Customs & Excise Business Brief 05/05, 3 March 2005

<sup>57</sup> The background to this reform in the statutory framework is given in, *Social Care aspects of the Health and Social Care (Community Health and Standards) Bill*, Library Research paper 03/39 2 May 2003.

<sup>58</sup> <http://www.csci.org.uk/>