



VAT on residential care

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In spring 2001 many Members were contacted by constituents concerned about reports in the press that, as a consequence of a VAT tribunal case¹ all residential homes would have to impose VAT on the fees they charge their residents. Briefly, the tribunal ruled that two residential homes – one caring for adults with learning disabilities, the other accommodating children in local authority care – were making standard-rated supplies. Generally the supply of care or medical and surgical treatment, and, in connection with it, the supply of any goods, in any hospital or other institution approved, licensed, registered or exempted from registration by a public general Act of Parliament is exempt from VAT.² HM Customs & Excise had taken the view that both homes were making exempt supplies. The partnership running the two homes – Kingscrest Residential Care Homes – challenged this ruling, as they wished to be registered for VAT.³

The tribunal held that the nature of care had to be ‘medically or surgically related’ to qualify for exemption under the existing legislation, buttressing its case by reference to the provisions for the exemption of hospital and medical care in European VAT law on which UK VAT law is based.⁴ In July 2001 Customs confirmed that it would appeal against the Tribunal decision, and that it was “considering alternative means by which the VAT exemption for residential care can be maintained.”⁵ On 20 March 2002 the High Court upheld the Tribunal’s decision. The same day the Government announced it had laid a statutory instrument – the *Value Added Tax (Health and Welfare) Order SI 762/2002* – “to ensure that residential care will remain free of VAT.”⁶ The Order took effect from 21 March 2002, and the Government has confirmed that “the decision of the VAT and Duties Tribunal in this case, and the later High Court judgment, do not impact upon any provision of nursing care.”⁷ The remainder of this note discusses the VAT liability of residential care and the implications of this particular case in more detail.

¹ *Kingscrest Associates Ltd & Montecello Ltd (VTD 17244)*, 14 May 2001

² under group 7, schedule 9 of the *VAT Act 1994*. The Act consolidates the main provisions in UK law relating to VAT. In the case of NHS Trusts, their supply of health care is not considered to be a business activity, and, as a consequence, is outside the scope of VAT (this is much the same as being VAT-exempt).

³ 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 turnover of *taxable* goods and/or services is above a given threshold, which is currently £58,000 (with effect from 1 April 2004).

⁴ specifically Article 13A(1)(b) of the sixth EC VAT directive (77/388/EEC)

⁵ HM Customs & Excise Business Brief 10/2001, 16 July 2001

⁶ HM Customs & Excise press notice PR 21/02, 20 March 2002

⁷ HC Deb 22 July 2002 c 822W

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A. The VAT treatment of care

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. Those supplies exempt from VAT are set out in schedule 9 of the *Value Added Tax Act (VATA) 1994*. In turn this list is based on the provisions harmonising the VAT base across all EU Member States, set out in the sixth EC VAT directive (77/388/EEC).⁸ In particular Article 13A1(b) of the sixth directive requires Member States to exempt “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.”

Group 7 to schedule 9 of *VATA 1994* covers the exemption of health supplies; item 4 to this list deals with the supply of care or medical and surgical treatment by hospitals, nursing homes and other similar bodies; it is reproduced below:

(4) The provision of care or medical or surgical treatment and, in connection with it, the supply of any goods, in any hospital or other institution approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act of Parliament or of the Northern Ireland Parliament or of a public general Measure of the Northern Ireland Assembly or Order in Council under Schedule 1 to the Northern Ireland Act 1974, not being a provision which is capable of being brought into effect and different times in relation to different local authority areas.

An extract from Customs’ guidance on this area of VAT law – looking at the scope of this exemption – is reproduced below:

The provision of care or medical or surgical treatment, and the supply of goods in connection with those services, to residents, infants or patients in the **hospitals or other institutions** eligible under item 4 of group 7 [of *VATA 1994* is exempt from VAT] ... In practice this covers accommodation, catering, medical aid nursing services, drugs, appliances etc. supplied in connection with the latter. The supply may be made by, or direct to, the institution, or by another body such as a charity catering to patients in hospitals, or by a firm supplying nursing services ...

⁸ The role played by EU law in setting the parameters for VAT law across the EU is discussed in, *VAT harmonisation*, Library Research paper 97/31 27 February 1997.

The term ‘care’ covers the medical treatment, protection, control and guidance of the individual, provided it involves some personal and continuing contact between the person supplying the service and the patient. It includes the provision of light refreshments (other than intoxicating liquor) provided to patients in the inpatients’ wards, the outpatients’ department or the casualty department of a hospital. It is not essential that the person providing ‘care’ should be medically qualified. Supplies made **outside** the institution are not covered by this exemption.⁹

Annex B to this guidance lists the hospitals and other institutions covered by this provision:

Examples of institutions to which item 4 of Group 7 of the Exemption Schedule applies

- National Health Service hospitals (but the provision of care, treatment and medical goods by them to patients is generally treated as outside the scope of VAT).
- Nursing homes or mental nursing homes registered under the Registered Homes Act 1984 or the Nursing Homes Registration (Scotland) Act 1938 or approved under the Abortion Act 1967 or exempted from registration under the 1984 Act as Christian Science homes or private mental hospitals registered under section 12 of the mental Health (Scotland) Act 1984.
- Residential homes registered under the Registered Homes Act 1984 for elderly or disabled people or for people with past or present dependence on alcohol or drugs or past or present mental disorder. (Part III accommodation under the National Assistance Act 1948 is not, as such, within this item, but it may be registered under a provision which does bring it within the item).
- Voluntary homes for children registered under section 57 of the Child Care Act 1980.
- Voluntary controlled or assisted community homes exempted from registration by section 41 of the Child Care Act 1980.
- Homes registered under section 61 of the Social Work (Scotland) Act 1968 (as amended by the Registered Establishments (Scotland) Act 1987).
- Probation/bail and bail hostels approved under section 49 of the Powers of Criminal Courts Act 1973.
- Nurseries and playgroups registered under the Children Act 1989.

The sixth directive also provides for the exemption of 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.”¹⁰ To this end, items 9 and 10 to Group 7 allow for the exemption of these supplies:

(9) The supply, otherwise than for profit, by a charity or public body of welfare services and of goods supplied in connection therewith.

(10) The supply, otherwise than for profit, of goods and services incidental to the provision of spiritual welfare by a religious community to a resident member of the

⁹ HM Customs & Excise, *Health : VAT Notice 701/31/92*, 1 March 1992 para 3(j).

¹⁰ Article 13A1(g) of the sixth EC VAT directive (77/388/EEC). Article 13A1(h) provides a similar exemption for services “closely linked to the protection of children and young persons.”

community in return for a subscription or other consideration paid as a condition of membership.

Notes 5 and 6 to Group 7 define the terms ‘public body’ and ‘welfare services’ as employed in item 9; they are reproduced below:

- (5) ‘Public body’ means –
- (a) a Government department within the meaning of section 41(6) [of *VATA 1994*]
 - (b) a local authority
 - (c) a body which acts under any enactment or instrument for public purposes and not for its own profit and which performs functions similar to those of a Government department or local authority.
- (6) In Item 9 ‘welfare services’ means services which are directly connected with-
- (a) the provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons;
 - (b) the protection of children and young persons: or
 - (c) the provision of spiritual welfare by a religious institution as part of a course of instruction or a retreat, not being a course or a retreat designed primarily to provide recreation or a holiday.¹¹

B. The Kingscrest residential care case

As mentioned above, in the case *Kingscrest Associates Ltd & Montecello Ltd*, the tribunal found, contrary to Customs assessment, that two residential homes – Conan Doyle House, caring for adults with learning disabilities – and 11 Gloucester Drive, caring for children placed there by the local authority – were *not* providing exempt care. In reaching its conclusion the tribunal argued that the term ‘care’ as used in item 4 to Group 7, and in the light of Article 13A1(b), “connotes care connected with medical or surgical treatment.” In fact, “Article 13A1, properly interpreted, leaves no room for ‘care’ as used in paragraph 1(b) to have a wider meaning than an activity closely related to ‘hospital and medical care’.” Part of the tribunal’s decision is reproduced below:

21. We start with Group 7. The heading "Health and Welfare" identifies the two classes of supplies for which exemption is to be given. Items 1 to 8 and 11 set out details of supplies of goods and services which, viewed broadly, belong in the health-related class, while items 9 (in conjunction with Note (6)) and 10 refer to supplies belonging in the welfare-related category. The word “care” is used in both the health-related class (item 4) and the welfare-related class (Note (6) attached to item 9). “Care”, when used in the definition of welfare services in Note (6) is fully defined to mean care “designed to promote the physical or mental welfare of elderly, sick,

¹¹ As noted, the law was amended by the *Value Added Tax (Health and Welfare) Order SI 762/2002*, to put the VAT exemption for residential care “beyond question” (HC Deb 22 July 2002 cc 822-3W). To this end it amended the wording of the provisions quoted above – in particular, items 4 & 9 and the Notes to group 7, schedule 9 of *VATA 1994*. This is discussed in more detail below.

distressed or disabled persons”; and the conditions for exemption as a supply of welfare services are fully spelt out in item 9.

Relevant to the situation at Conan Doyle House, the services would, to be exempt, have to have been directly connected with the provision of care to promote the physical and mental welfare of the disabled persons residing there. That, on the facts as we have found in paragraph 7 above, was the case. Relevant to 11 Gloucester Drive, the services would, to be exempt, have to have been directly connected with the protection of children and young persons; that also we have found, in paragraph 15, to have been so. Thus both Conan Doyle House and 11 Gloucester Drive pass the tests as regards the specific description of their services. They fail to qualify for exemption because, as we have noted, the provider supplies them for profit and because it does not have the status of a public body (within Note (5)).

22. Unlike item 9, item 4 uses the word “care” without specifying the sort of person who is to be cared for. The only express qualification is that the care should be provided in a hospital or in some other approved institution. The association of the word “care” with the words “medical or surgical treatment” provides a strong implication that the nature of the care must be medically or surgically related if it is to qualify for exemption under item 4. Moreover, it seems to us unlikely that the draftsman had welfare care (of the sort provided at Conan Doyle House and 11 Gloucester Drive) in mind as care falling within item 4, when later in the Group he wrote out a specific description of what he meant.

23. The irresistible inference from the wording and structure of Group 7 is that the word “care”, in item 4, is used in a medically or surgically related connotation. [HM Customs & Excise’s counsel] attacked this. To construe “other institution” as “any hospital” or something of a similar nature would necessarily render the former expression otiose because the former expression would come within and add nothing to the words “any hospital”; moreover the word “or” in item 4 indicates that other approved institutions are an additional alternative to hospitals of any sort. We do not agree. There are, we think, institutions other than hospitals that provide care of a medical or surgical nature. We have convalescent homes and nursing homes in mind. They provide examples of “other institutions” and demonstrate why those words were inserted.

24. Our conclusion so far, based on the law of the United Kingdom, is that the care provided at Conan Doyle House and at 11 Gloucester Drive was intentionally excluded from exemption by the framers of Group 7. This, we think, follows also from the proper construction and application of the words of Article 13A1(b). Article 13A.1, in common with Group 7, deals specifically with services closely linked to welfare and social security work (in paragraph 1(g)) and to the protection of children and young persons (in paragraph 1(h)); and, in common with item 9 and Note (6) of Group 7, it imposes conditions that the provider has to fulfil. Paragraph 1 (b) to (e) of Article 13A is directed at supplies of treatment, care and goods of a hospital and medical nature; and in paragraph 1 (b), (c) and (e) conditions are imposed that must be fulfilled if exemption is to be obtained.

There is nothing in the wording of paragraph 1 (b) of Article 13 A that requires the expression “closely related activities” to be given a meaning which extends beyond

the bounds of hospital and medical care-type activity; nor is there anything in the context that requires that “establishments of a similar nature” should extend to institutions, such as Conan Doyle House and 11 Gloucester Drive which themselves provide neither medical treatment nor diagnosis. That conclusion is, we note, in line with the observation of the ECJ in *EC v UK* [1988] STC 251 where it was said, in paragraph 32 on page 265, of paragraph 1(d) of Article 13A -

“The services involved therefore encompass the whole range of medical care normally provided on a non-profit-making basis in establishments pursuing social purposes such as the protection of human health.”

24. For those reasons we think that the care services provided by the Partnership at Conan Doyle House and 11 Gloucester Drive are not exempt from VAT. They are outside the scope of Article 13A1(b) with which item 4 of Group 7 of Schedule 9, properly construed, complies.¹²

Press reports that the case would result in VAT being imposed on all residential care¹³ lead to the issue being raised by Angela Browning with the then Leader of the House, Robin Cook during Business Questions on 28 June 2001. On this occasion Mr Cook said:

The hon. Lady is right to draw attention to the decision of a VAT tribunal in an individual case. The Government’s position is clear: we do not believe that vulnerable people provided with care in residential homes should have to face VAT or be subject to it. There will be an appeal against the judgement. Whatever the outcome, we shall ensure that those in residential homes do not have to face increased costs as a result of the ruling.¹⁴

On 16 July 2001 Customs set out the practical implications of the case in a business brief:

Background - Government's Position The Government is of the clear view that care of vulnerable people provided in residential homes should not be subject to VAT.

Tribunal Decision Kingscrest, a commercial body operating care homes for children and for young adults with learning difficulties, brought this case to test the established position that residential care services are VAT exempt. The Tribunal found that the appellant’s supplies of residential care were not medically or surgically related and did not therefore qualify for exemption, but should be subject to VAT at the standard rate. The Tribunal confirmed that care provided in nursing and convalescent homes, by local authorities and by non-profit making organisations (charities) is properly exempt.

¹² *Kingscrest Associates Ltd & Montecello Ltd (VTD 17244)*, 14 May 2001. A summary of the decision was given in *Simon’s Weekly Tax Intelligence* 26 July 2001 pp 1066-7.

¹³ For example, “VAT on care home bills”, *Daily Mail*, 27 June 2001 & “Anger over VAT care threat on elderly care”, *Guardian*, 28 June 2001.

¹⁴ HC Deb 27 June 2001 cc 779-780. The issue was raised by Paul Burstow MP in an early day motion which attracted 54 signatures (EDM 37 2001-02, 27 June 2001).

Practical Implications Customs have notified an intention to appeal against this Tribunal decision. Until the appeal has been heard, the VAT treatment of the residential care sector as a whole remains unchanged. Any residential care home that was properly exempting their supplies prior to the decision should therefore continue to do so. In addition to lodging an appeal, Customs are also considering alternative means by which the VAT exemption for residential care can be maintained.¹⁵

C. Recent developments

The appeal was heard in February 2002, and on 20 March the High Court upheld the Tribunal's decision.¹⁶ The same day the Government announced it had laid an Order "to ensure that residential care will remain free of VAT." The implications of the judgement were set out in more detail in a business brief on 21 March:

This Business Brief sets out Customs' policy on the VAT liability of commercially provided residential care. It follows a High Court ruling against Customs' view that residential care, provided in an appropriately licensed care institution, was exempt from VAT as care provided in a hospital or other similar establishment.

Background The High Court supported the VAT Tribunal decision (in the case of Kingscrest Associates Ltd & Montecello Ltd) that care provided commercially by Kingscrest, in its residential homes for children and young adults with learning difficulties, was not medical in nature. The exemption from VAT in UK and EC law, for care provided in hospitals and other similar establishments, did not therefore apply. However, the Tribunal did confirm that care provided in nursing and convalescent homes was medical in nature, and therefore exempt from VAT under this provision. It also confirmed that residential care services provided by charities and local authorities remain VAT exempt under separate provisions relating to welfare services provided otherwise than for profit.

Implications Business Brief 10/2001 (July 2001) confirmed that commercial providers of residential care should continue to regard their supplies as VAT exempt pending the outcome of Customs' appeal. Customs' view is that while the High Court's decision means that commercially provided residential care (other than nursing or medical care) does not qualify for exemption as care in a hospital or other similar establishment, it does qualify for the exemption that applies to residential accommodation. However, in order to remove any doubt about exemption for residential care, the Government has laid the Value Added Tax (Health and Welfare) Order before Parliament. Subject to Parliamentary approval, the Order will be

¹⁵ HM Customs & Excise Business Brief 10/2001, 16 July 2001. In addition the then Financial Secretary, Paul Boateng, confirmed the Government's position in several PQs (for example, HC Deb 3 July 2001 c 127W; HC Deb 13 November 2001 c 608W; HC Deb 4 March 2002 cc 116-7W).

¹⁶ *Customs & Excise Commissioners v (1) Kingscrest Associates Ltd (2) Montecello Ltd (together t/a Kingscrest Residential Care Homes)* [2002] EWHC 410 (Ch)

effective from 21 March 2002. Residential care providers who were exempting their supplies prior to the judgement should therefore continue to do so.¹⁷

To ensure that residential care continues to be VAT-exempt, the Order amended the wording of the provisions in group 7, schedule 9 of *VATA 1994* quoted above. Item 4 to group 7, dealing with the supply of care or medical and surgical treatment, was changed to read “(4) The provision of care or medical or surgical treatment and, in connection with it, the supply of any goods, in any hospital *or state-regulated institution*” (*emphasis added*). A new note to group 7 defined this term as follows:

(8) In this Group "state-regulated" means approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act, other than a provision that is capable of being brought into effect at different times in relation to different local authority areas.

Here "Act" means -

- (a) an Act of Parliament;
- (b) an Act of the Scottish Parliament;
- (c) an Act of the Northern Ireland Assembly;
- (d) an Order in Council under Schedule 1 to the Northern Ireland Act 1974;
- (e) a Measure of the Northern Ireland Assembly established under section 1 of the Northern Ireland Assembly Act 1973;
- (f) an Order in Council under section 1(3) of the Northern Ireland (Temporary Provisions) Act 1972;
- (g) an Act of the Parliament of Northern Ireland.

The Order also amended item 9 and note 6 to group 7, dealing with the VAT-exemption of welfare services, so that it would be clear the exemption includes services provided by ‘state-regulation private welfare institutions’, even if provided for a profit, and that these services include care directly connected with children and young persons. Item 9 and note 6 were amended to read as follows:

(9) The supply by -

- (a) a charity,
- (b) a state-regulated private welfare institution, or
- (c) a public body,

of welfare services and of goods supplied in connection with those welfare services.

(6) In item 9 "welfare services" means services which are directly connected with

- (a) the provision of care, treatment or instruction designed to promote the physical or mental welfare of elderly, sick, distressed or disabled persons,
- (b) the care or protection of children and young persons, or
- (c) the provision of spiritual welfare by a religious institution as part of a course of instruction or a retreat, not being a course or a retreat designed primarily to provide recreation or a holiday,

¹⁷ HM Customs & Excise Business Brief 07/2002, 21 March 2002

and, in the case of services supplied by a state-regulated private welfare institution, includes only those services in respect of which the institution is so regulated.¹⁸

It is worth noting that, on a separate but related topic, in December 2002 the Government announced a change in the VAT treatment of domestic care, to accompany the statutory regime of regulation of private welfare agencies.¹⁹ Under the *Value Added Tax (Health and Welfare) Order* SI 2003/24 – which came into force on 31 January 2003 – the list of institutions in item 9 to group 7 was amended a second time, to extend this exemption to all welfare services provided by state-regulated private welfare agencies.²⁰

Finally, turning back to the case of Kingscrest Residential Care Homes, following the change in the law described above, Customs de-registered the partnership “from 21 March 2002 on account of the fact that from that date, as a state-regulated private welfare institution it was making exempt supplies of welfare services.”²¹ Kingscrest made a second appeal to the tribunal on the grounds that the UK domestic law as amended did not properly reflect the meaning of the relevant provisions in European law. At the hearing of the appeal in June 2003 the parties requested, and the tribunal agreed to, a reference to the European Court of Justice on three questions. A summary of the hearing is reproduced below:

The appellants run care homes for profit. Having won a decision in the High Court to the effect that their services were standard-rated, the appellants now appealed against Customs’ decision to deregister them, on the ground that they were making exempt supplies following a change in the law. From 31 March 2002 VATA 1994 Sch 9 Group 7 item 9 exempts supplies, by a state-regulated private welfare institution, of welfare services.

It was accepted by the appellants that they were state-regulated private welfare institutions supplying welfare services but they argued that the new item 9 was *ultra vires* in relation to the Sixth VAT Directive 77/388/EEC. Article 13.A.1 of the latter instructs Member States to exempt (g) welfare services and (h) services for the protection of children supplied in each case “by bodies governed by public law or by other organisations recognised as charitable by the Member State concerned”. Article 13.A.2 goes on to allow Member States to limit the exemption, for bodies other than those governed by public law, to those which do not systematically aim to make a profit.

The Tribunal decided to refer the matter to the European Court of Justice. Its questions define the issues neatly—

¹⁸ Customs’ guidance on the law was updated to take account of these changes: *Health and care institutions: VAT Notice 701/31*, March 2002. It can be downloaded from Customs site: www.hmce.gov.uk

¹⁹ 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.

²⁰ Details on this change are given in, “VAT on domestic care supplied by private businesses”, Library standard note SN/BT/1027, 21 July 2004.

²¹ “Welfare wars”, *Tax Journal*, 28 July 2003

Is it permissible to resort to other language versions of the Sixth Council Directive 77/388/EEC to elucidate the meaning of the word “charitable” in Article 13.A.1(g) and (h), or must the word have the same meaning as in domestic law?

If Article 13.A.1(g) and (h) are to be interpreted as applying to an of organisation that is recognised as having a social character, are they to be interpreted as applying to a profit-making entity such as the Kingscrest Residential Care Homes Partnership?

Are Article 13.A.1(g) and (h) of the Directive to be interpreted as meaning that they confer on Member States a discretion to recognise for the purposes of those provisions an organisation which is registered under the Care Standards Act 2000 (or the Registered Homes Act 1984 or the Children Act 1989) but which is not a body governed by public law and does not have the status of a charity under the domestic law of the member State concerned?²²

To date the ECJ has not made its response to this request.

²² “*Kingscrest Associates Ltd & Montecello Ltd t/a Kingscrest Residential Care Homes (18184)*, 10 June 2003”, *Simon’s Weekly Tax Intelligence* 11 September 2003 p 1579