



VAT ON INCONTINENCE PRODUCTS

Standard Note

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In this country VAT is charged on the supply of all goods and services, unless specifically exempt, either at the standard rate - currently 17½% - or the zero rate.¹ Zero-rated supplies are set out in schedule 8 to the *VAT Act (VATA) 1994* – and group 12 to this schedule covers certain specified supplies made to disabled people. As a consequence, the supply of incontinence products - as well as drugs, medicines, and other aids - are generally charged a zero rate of VAT when sold to handicapped individuals. Item 1 of group 12 allows any goods to be zero-rated if dispensed on prescription by a registered medical practitioner. Item 2 allows a specified list of goods to be zero-rated if supplied to a handicapped person for domestic or personal use, or to a charity which makes them available for the domestic or personal use of handicapped people.²

The mechanism for claiming VAT relief on these supplies works on the basis of self assessment. Individuals living in their own homes and suffering from incontinence declare to suppliers that they are chronically sick or disabled and are therefore entitled to purchase zero-rated continence pads.³ These declarations are held by the retailers; as a consequence it is not known how many people are eligible for or claim VAT relief on incontinence products under this procedure.⁴ Further details on the administration of this relief are published by HM Customs & Excise.⁵

Of course patients may be supplied with incontinence products as part of their general health care - either through the NHS or in a private hospital or nursing home. Health care through the NHS is free of charge, and although patients in commercial establishments are charged for these services, they do not pay VAT on the bill. This is because the supply of care or medical and surgical treatment, and, in connection with it, the supply of any goods, by private hospitals and nursing homes is exempt from VAT, under group 7, schedule 9 of *VATA 1994* (specifically item 4). 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 (in essence this is much the same as being exempt from VAT).

¹ There is one exception to this: a reduced rate of 5% is charged on the supply of domestic fuel and power, and the installation of energy saving materials, under schedule A1 to *VATA 1994*. The reduced rate was extended to sanitary protection from 1 January 2001.

² In addition, item 2(g) specifies goods for domestic or personal use “designed solely for use by a handicapped person,” and item 3 covers “the supply to a handicapped person of services of adapting goods to suit his condition.” The other items in group 12 cover the supply of specified services to handicapped persons, or to charities providing help for these persons.

³ HC Deb 17 July 2000 cc 92-93W

⁴ HC Deb 13 July 2000 c 687W

⁵ *VAT reliefs for people with disabilities VAT Notice 701/7/94*, 1 August 1994 This is available from Customs' internet site at: www.hmce.gov.uk/notices/701-07.htm

In November 1997 the Government introduced legislation which affected the VAT treatment of incontinence products, as well as drugs and prostheses, when supplied to these *organisations* - NHS Trusts, private hospitals and nursing homes - *rather* than when supplied to individuals. The *Value Added Tax (Drugs, Medicines and Aids for the Handicapped) Order SI 1997/2744* was laid on 18 November 1997, and came into force on 1 January 1998.⁶

These changes represented the Government's response to two legal cases: one decided by the Court of Appeal (known as 'BUPA & Wellington')⁷, one by a VAT Tribunal (known as 'Mölnlycke').⁸ Both involved these organisations setting up contractual arrangements to reduce their own VAT bills, by acting as an intermediary between patients and product manufacturers. By having incontinence products supplied directly to their patients, hospitals were able to have these individual items zero-rated for VAT, rather than VAT-exempt as part of their general supply of health care.⁹

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. As a result there is a financial incentive for businesses to find a way to have supplies zero-rated for VAT rather than classified as an exempt supply.

HM Customs & Excise estimated that schemes of this type threatened to cost the Exchequer up to £300 million a year, and the Government announced its intent to amend the relevant legislation in August 1997.¹⁰ Since these changes took effect, the issue has been raised several times in written questions, particularly in the context of its impact on local health authorities. A short selection of these PQs is reproduced below:

Mr. Burstow: To ask the Secretary of State for Health what the extra cost to the NHS would be if VAT was applied to home-delivered continence products at 17.5 per cent.

Mr. Boateng: Under the Value Added Tax Act 1994, Schedule 8, Group 12, Item 2(g) incontinence products are only zero-rated when supplied to a disabled person or to a charity that makes them available to a disabled person. As the National Health

⁶ The Order was debated in the Second Standing Committee on Delegated Legislation on 2 December 1997; it was voted on by the House on 9 December 1997, and approved by 262 votes to 57 (HC Deb 9 December 1998 c 913).

⁷ C & E Comrs v British United Provident Association Ltd; British United Provident Association Ltd v C & E Comrs; C & E Comrs v Wellington Private Hospital Ltd; C & E Comrs v St Martins Hospital Ltd - Court of Appeal, 23 January 1997 (reported in, *Simon's Weekly Tax Intelligence*, 30 January 1997 pp 124-129).

⁸ 14641 Mölnlycke Ltd v C & E Comrs, *Simon's Weekly Tax Intelligence*, 13 March 1997 pp 371-373

⁹ Further details are given in HM Customs & Excise VAT Information Sheet 6/97, December 1997. This is available from Customs' site at: www.hmce.gov.uk/notices/info697.htm

¹⁰ HM Customs & Excise press notice, 13 August 1997

Service falls into neither of these categories, it has always been the intention that supplies of these products by the NHS should have been standard rated and the NHS is funded on this understanding. Since there is no change to this intention, there will be no associated increased cost for the NHS. NHS trusts have been temporarily able to take advantage of a VAT reimbursement on these products due to a loophole which Customs and Excise are now seeking to close.¹¹

Mr. Burstow: To ask the Secretary of State for Health how health authorities and trusts are notified of the amounts in their allocations which are provided to fund them to meet the costs of VAT on incontinence products.

Mr. Milburn: There is no separate allocation of funds to health authorities in respect of Value Added Tax liability. National Health Service trusts receive most of their income through contracts with commissioners of health care services, i.e. health authorities and general practitioner fundholders. Contract prices are intended to recover all relevant costs including liability to VAT.¹²

Mr. Burstow: To ask the Secretary of State for Health what estimate his Department has made of the cost to NHS trusts of the removal of VAT zero-rating on continence products in (a) 1997-98 and (b) 1998-99.

Mr. Boateng: The National Health Service is funded on the basis that Value Added Tax is payable on healthcare. The re-imposition of VAT on continence products is estimated to amount to £2.25 million in 1997-98 and £9 million in 1998-99.¹³

Mr. Burstow: To ask the Chancellor of the Exchequer, pursuant to his answer of 19 March 1998, Official Report, column 671, concerning the VAT Tribunal decision in respect of continence products, for what reasons he decided to reimpose VAT in each case where the tribunal had ruled that relief should apply.

Dawn Primarolo: The VAT relief for continence products was used by several NHS Trusts, which entered into contractual arrangements with a third party to gain a tax advantage. As NHS Trusts are funded for the VAT they cannot recover, the tax advantage amounted to double funding. We therefore introduced a change of law to restore the status quo.¹⁴

Mr. Burstow: To ask the Chancellor of the Exchequer, pursuant to his answer of 19 March 1998, Official Report, column 671, concerning the VAT Tribunal and continence products, if he will list (a) the cases when VAT relief applied and (b) the cases where VAT relief did not apply.

¹¹ HC Deb 3 December 1997 c 262W

¹² HC Deb 8 December 1997 cc 459-460W

¹³ HC Deb 2 March 1998 c 487W In answer to a similar question in May 2000, John Hutton, Minister of State at the Department of Health stated, "details of expenditure on continence products are not held centrally. The estimate of £9 million per annum given in the reply to the hon. Gentleman on 2 March 1998, Official Report, column 487W, was based on an earlier study. However, there is no reason to suppose that this estimate is not valid for 1999-2000 and 2000-01" (HC Deb 15 May 2000 c 19W).

¹⁴ HC Deb 2 April 1998 c 616W

Dawn Primarolo: The VAT Tribunal in Molnlycke Ltd. examined four contracts. It decided that supplies of continence products under the contracts with Aylesbury Vale Community Health Care Trust and Chester and Halton Community NHS Trust for patients in their own homes were zero-rated. However, it ruled that supplies of those goods for residents under the contract with Westgate House Nursing Home and for the majority of patients of Edinburgh Healthcare NHS Trust were standard-rated.¹⁵

When this Order was debated in Standing Committee in December 1997, the then Financial Secretary – now Paymaster General – Dawn Primarolo, replied to concerns about its potential impact for the NHS and for patients receiving care either at home or in hospital:

At the instigation of Molnlycke a scheme was contrived to deliver incontinence pads directly to the patient at home. It made no difference to the patient whether the supplies were delivered at home or via the health service; VAT is not paid ... Despite the fact that the National Health Service is funded for its VAT through its public expenditure settlement, some trusts have been encouraged by tax advisers to pursue money that they have not paid. They have already received refunds ...

The order will have no effect on the supply of incontinence products to patients in their homes. When the supplies are provided by the National Health Service, the handicapped person will continue to receive them at no charge. Incontinence products are tax free when they are bought by a handicapped person. It has been suggested that the Government are penalising people who are incontinent and who are in institutions. That is not so. Incontinence pads are an integral part of an incontinent patient's care in a hospital, nursing home or residential home. As such, they are supplied in connection with the institution's exempt or non-business care.

It has also been suggested that the Government are penalising people who live in their own homes, and whose incontinence products are paid for by the National Health Service ... That, again, is not true. Those people will not be penalised and will continue to receive their incontinence products from the national health service at no charge. The order will not slash the national health service budget for incontinence pads because the national health service is already funded in that respect ...

It has been suggested that the order would undermine the importance of home care for the delivery of incontinence products. That is not the case. The Government are trying to ensure that the national health service does not take advantage of tax avoidance schemes solely to receive VAT back when it has already been funded in that respect. That is double funding and if we allow the public sector to engage in avoidance and, when it does so successfully, to keep the sums concerned, in partnership with the private sector, we undermine the principle of the payment of taxes and of funding based on need through the public sector settlement ...

The order is clear: exempt and zero-rated supplies and the impact on the patient are unchanged; there will be no passing on of VAT to the patient. The order deals with a

¹⁵ HC Deb 2 April 1999 c 616W

contrived and complex avoidance mechanism in which money is sought either when payment has been made through funding or when the supply is clearly exempt. If I were to tell members of the Committee that a company had deliberately predicated its business and the supply of its products on exploiting taxation legislation to recover a payment that Parliament did not intend it to have, they would say that that was unfair.

The best way to fund the National Health Service is through the public sector on the basis of needs assessment. We should raise money through taxes and distribute it in that way, not allow it to be corrupted by some trusts which we have been advised can recover more money than others. That is simply unfair. Therefore, we have introduced the order.¹⁶

Despite the Government's assurances that this avoidance legislation would not have any significant impact on the level of continence care provided by the NHS, the issue has continued to attract attention.¹⁷ There *have* been some official concerns about the impact of the Order, not in relation to incontinence products, but to certain renal and cancer drugs.

At the time SI 1997/2744 was laid in November 1997, Customs were concerned that some NHS trusts had not made financial provision for its full impact; in particular, some NHS renal units treating patients in their own homes had been buying dialysis liquids at a zero rate of VAT. Generally patients requiring dialysis drugs will be under the management of a specialist unit. From the patient's perspective, the VAT treatment of dialysis liquids purchased by the NHS is irrelevant, since they are not charged for their treatment, though zero-rating has obvious financial advantages from the point of view of the provider of health care (in this case the NHS trust).¹⁸ In November 1998 the Government decided to give NHS trusts time to adjust to the impact of this measure, and delayed its implementation - insofar as it affected trusts buying certain renal and cancer drugs - until 1 April 1999:

Mr. Burstow: To ask the Secretary of State for Health if his officials have concluded their review of the impact of the introduction of the VAT Order SI 1997/2744; and if he will make a statement.

Mr. Milburn: Officials have concluded their review of the impact of the introduction of the Value Added Tax Order Statutory Instrument 1997/2744. They are now working closely with Her Majesty's Treasury officials to finalise the administrative procedures to ameliorate the effect of the VAT Order on the supply of certain renal and cancer drugs and on the supply of pharmaceutical products by retail pharmacists to residents of nursing homes. The VAT Order also affected certain incontinence supplies. A review of continence policy is currently underway which is intended to

¹⁶ Second Standing Committee on Delegated Legislation, 2 December 1997, cc 5-6 c 23

¹⁷ For example, Paul Burstow MP moved an EDM in February 1999, calling on the Government "to compensate the NHS for lost VAT at £11.25 million ... and to reverse the effects of SI 1997/2744", which attracted 80 signatures (EDM 342 1998-99 "Value added tax" 22 February 1999).

¹⁸ Also, patients provided with renal care by a private establishment are unaffected by the VAT position of goods supplied as part of their medical care, since this supply is exempt from VAT.

ensure that the most appropriate and effective continence services are being planned and delivered.¹⁹

In December 1998 the Government confirmed that increased funding for NHS renal units trusts affected by this change would be available by 1 April 1999, and that a second unrelated aspect of the Order would not be implemented:

Mr. Burstow: To ask the Secretary of State for Health what assessment he has made of the (a) financial and (b) other effects of the VAT order on the supply of certain renal and cancer drugs and on pharmaceutical products by retail pharmacists to residents of nursing homes.

Mr. Milburn: The financial effect of the Value Added Tax Order on the supply of certain renal and cancer drugs was estimated at £3.5 million per annum. The Order is not being implemented for these items until 1 April 1999, when the increased funding available to the NHS will be in place. The effect of the VAT Order on the supply of prescribed items by retail pharmacists to residents of nursing homes would be to make such items subject to VAT at the standard rate. However, there would be significant problems in altering NHS systems to comply with the Order and, as a result, Her Majesty's Treasury has decided not to implement this aspect of the Order. There are no other effects of the VAT Order on the supply of certain renal and cancer drugs and on pharmaceutical products by retail pharmacists to residents of nursing homes.²⁰

At the time of the March 2000 Budget the Government announced that a new 5% VAT rate would be introduced on women's sanitary products from 1 January 2001.²¹ Following the Budget, HM Customs & Excise consulted trade groups to establish a clear and workable definition of those sanitary products to be taxed at the reduced rate. In June 2000 it published a draft of the proposed legislation and a draft Regulatory Impact Assessment; in a covering letter, Customs explained the scope of the new VAT relief (*emphasis added*):

In drafting the legislation we have sought to produce a clear, simple and workable reduced rate for products that are clearly designed for women's sanitary protection e.g. of the pad, tampon, panty liner nature. The reduced rate will not apply to complimentary products such as feminine wipes, lined pants and sprays. *The reduced rate specifically excludes all products designed for urinary incontinence because relief in the form of a zero rate is already available when such products are bought by incontinent people living in their own homes.* Clearly there is no intention to introduce VAT on a supply where VAT does not currently apply.²²

¹⁹ HC Deb 17 November 1998 c 561W

²⁰ HC Deb 2 December 1998 c 211W

²¹ This change was implemented under the *Value Added Tax (Reduced Rate) Order* SI 2000/2954. The issue is examined at more length in a second standard note: "VAT on sanitary protection", 8 December 2000.

²² HM Customs & Excise, *VAT: Women's sanitary protection products*, June 2000. Details of this consultation are published on Customs' internet site at: www.hmce.gov.uk/bus/vat/san-ria.htm

At this time Paul Burstow MP tabled an EDM, arguing that the 5% reduced rate should cover all incontinence products as well:

That this House welcomes the proposal announced in the Budget to lower VAT on women's sanitary products to 5 per cent. from 1st January 2001; agrees that women's sanitary products are not luxury consumer products; notes that continence products also classify as sanitary products and are not luxury consumer products; and calls on Her Majesty's Government to ensure that their definition of sanitary products will allow for the lowering of VAT to 5 per cent. on continence products, which are required, according to Government estimates in Good Practice in Continence Services, by up to 20 per cent. of the female population under 65 years, 40 per cent. of women aged over 65 years and between 7 to 10 per cent. of men aged over 65 years.²³

The Paymaster General, Dawn Primarolo, set out the Government's reasons for excluding incontinence products when the Order introducing the reduced rate on sanitary protection was debated in Standing Committee on 23 November.²⁴ Ms Primarolo also announced that Customs would consult with the trade on how to ensure that those entitled to zero rating on incontinence products received this VAT relief, adding she could not "give a timetable, and it would be cavalier of me to do so until we know precisely the extent of the problem. We shall speak to all those concerned to establish that."²⁵ Details of these arrangements, which are to come into effect on 1 October 2001, were published recently – and reproduced below.²⁶ An extract from the Paymaster General's speech during the Standing Committee debate in November last year is provided first:

When they are bought by incontinent people living in their own homes, [incontinence products] are zero rated; when they are supplied to patients in private nursing homes and hospitals, they are exempt; and in the national health service they are free of charge. The Continence Campaign says that, for a variety of reasons, incontinent people do not buy the products at the zero rate and urged us to move from the zero rate to 5 per cent. I do not believe that that will solve the problem. Applying a tax to incontinence products is not the best way of dealing with the issue.

The matter is not strictly covered by the order, but, because many members of the Committee will be interested, I hope that you, Dr. Kumar, will allow me to tell the Committee what I have asked Customs and Excise to do. We have been informed that, for reasons personal to incontinent people and because of the complexity of adapting tills in places of purchase, there is either a reluctance to say that someone

²³ EDM 850 1999-00 "VAT on continence products" 13 June 2000 This attracted 128 signatures. The Government confirmed its opposition to this proposal in a written answer given in the Lords (HL Deb 1 November 2000 c 101WA).

²⁴ Fourth Standing Committee on Delegated Legislation, *Value Added Tax (Reduced Rate) Order 2000*, 23 November 2000

²⁵ *op.cit.* c 12

²⁶ HM Customs & Excise Business Brief 12/2001, 11 September 2001

may be entitled to the reduced rate because of incontinence or because suppliers are unable to cope with deduction of VAT.

It is important to preserve the zero rate, so I have asked Customs and Excise to hold discussions with the trade and the Continence Campaign to find ways—administrative ways, I hope—in which we can apply the zero rate to those people to whom it should apply, because that will be far easier and will remove some of the problems that they experience. If that is impossible, we shall have to consider whether to impose a tax. I am sure that all members of the Committee agree that if we can maintain a zero rating we should do so ...

Mrs. Claire Curtis-Thomas (Crosby): I know that there is to be consultation on the zero rating of incontinence products and on enabling people who find themselves in need of such products easily to reclaim tax, but if the exercise is protracted those concerned may incur significant costs. Has the Minister defined objectives by which it is to be concluded, at which point we would be able to consider further proposals?

Dawn Primarolo: I want it to be done as quickly as possible. I appreciate that those who are not claiming at the reduced rate may find doing so a source of difficulty and embarrassment. Consultation will help us to establish the scale of the problem and give us an opportunity to consider the procedures.

I am sure that my hon. Friend understands that, although we need to make speedy progress, we must ensure that we do not inadvertently open up a loophole in the legislation whereby other parties—not individuals—can claim a reduced rate to which they are not entitled. We introduced some anti-avoidance measures in relation to connected services because the Government were losing money as a result of technicalities that enabled the relief to be given beyond our intentions.

We need to balance the two objectives. It is important that people who are entitled to a zero rate are able to buy the product at the reduced rate, without having to claim the money back.²⁷

As mentioned above, Customs has recently published details of new arrangements – to take effect from 1 October 2001 – for zero-rating incontinence products purchased through retail outlets by entitled people:

Background

People who are incontinent and live in their own homes are entitled to buy incontinence products at the VAT zero rate. A condition of the zero-rating is that retailers obtain a declaration from the purchaser confirming that they are eligible for VAT relief. Some retailers find it difficult and expensive to adapt systems to meet the needs of customers who are eligible to buy these goods at the VAT zero rate. Equally, many incontinent people are unaware that they are eligible for VAT relief, or are simply reluctant to draw attention to their condition. Customs, after consultation with

²⁷ Fourth Standing Committee on Delegated Legislation, 23 November 2000 cc 3-5

manufacturers, retailers and representative bodies, are now introducing easier arrangements in order to improve access to the VAT zero-rate by people who are eligible.

New VAT treatment for retail sales from 1 October 2001

The main change is that eligible incontinence products, for retail sale, may be zero-rated on the shelf. In practice, this means that an incontinent person may purchase incontinence products at any till and receive automatic zero-rating. There will no longer be a requirement for the customer to provide a written declaration to the retailer confirming they are eligible for VAT relief. Due to the specialist nature of these products, Customs believe that only entitled people are likely to buy them. Internet and mail order sales Supplies of eligible incontinence products over the Internet or by mail order also qualify for VAT relief providing they are made to individuals and not institutions.

Restrictions

Customs will expect retailers, Internet and mail order suppliers to have a signed declaration, or other supporting evidence that the supply is to an incontinent individual and not to an institution such as a nursing home, for customers who buy more than:

- 200 disposable pads, or
- 50 washable pads, or
- 5 collecting devices, or
- 10 pairs of waterproof or leak-proof underwear.

Goods that qualify for zero rating on the shelf

Disposable and washable incontinence pads including pads that are incorporated in briefs, underwear designed for use by an incontinent person (i.e. underwear that is waterproof or leak-proof), and collecting devices.

Nursing homes/National Health Service

These new measures do not change the VAT liability of incontinence products. Consequently, they do not affect the VAT position of nursing homes, hospitals or the NHS who continue to remain ineligible for VAT relief on the purchase of incontinence products.

"The decision to remove VAT from continence pads' shelf price is a real step forwards. It means that people will pay a fair price and it also removes the embarrassment of trying to reclaim VAT at the shop till. We hope that retailers will draw customers' attention to the lower prices when they come into effect on 1 October. This will have a real effect on the lives of thousands".²⁸

Antony Seely
Business & Transport Section

²⁸ HM Customs & Excise Business Brief 12/2001, 11 September 2001