Introduction

For hospices, one potential impact of GP Commissioning is the VAT status of funding from the NHS will switch from being non-business (or outside the scope of VAT) to being VAT exempt. Many hospices are currently funded by NHS grants, however it seems likely that at least some of this funding will switch to a contract basis. Contract basis funding is normally seen as a business supply and business supplies of professional medical care and of charitable welfare services are VAT exempt.

For a hospice where funding does change in this way there are two potentially significant consequences for VAT on buildings:

1. **Zero-rated buildings**: hospices may no longer be able to zero-rate the construction or purchase of non-residential hospice buildings. This means the cost of purchasing or constructing a new non-residential building may increase by up to 20%.

2. **Change of use rules**: hospices that have zero-rated the construction or purchase of a new non-residential building within the last 10 years may have to pay some of the VAT saved through zero-rating to HMRC under the VAT “change of use rules”

However there are ways in which these scenarios might be avoided:

3. **Revenue & Customs Brief 29/07**: a hospice may be able to rely on an announcement made by HMRC in Revenue & Customs Brief 29/07 in order to ignore any change of use

4. **Non-business contract**: even though NHS funding is provided on a contractual basis, it may still be non-business for VAT purposes. If this is the case, a hospice will still be able to zero-rate new non-residential buildings and the funding change will not trigger the change of use rules
Zero-rated buildings

A charity can zero-rate certain building related purchases.

Zero-rating means the charity tells the supplier not to charge any VAT when VAT would normally be chargeable. This is advantageous if the charity is not VAT registered or is VAT registered but cannot recover all the VAT it incurs on purchases. As building contracts often run into millions of pounds, the VAT saving can be considerable.

Two of the zero-rating reliefs relate to new charitable or residential use buildings:

1. **Purchases of new buildings**: The first sale by its developer of the freehold or a long lease in a building intended for use solely for a “relevant charitable purpose” or for a “relevant residential purpose” is zero-rated

2. **Construction of new buildings**: Qualifying supplies in the course of construction of a building intended for use solely for a relevant charitable or residential purpose are also zero-rated. Qualifying supplies are services of builders and contractors and associated supplies of building materials but some supplies are specifically excluded, for example services of architects, surveyors, consultants and supervisors

Use for a relevant charitable purpose means use for non-business activities, for example use for activities funded wholly by grants, donations, reserves or investment income. Use for a relevant residential purpose includes use as a residential hospice.

As a result of these two zero-rating reliefs:

- Many hospices have been able to zero-rate the purchase or construction of new residential hospice buildings under the relevant residential purpose option
- Many hospices have also been able to zero-rate the purchase or construction of new non-residential hospice buildings under the relevant charitable purpose option, on the basis the activities carried out in the building will be non-business

If GP commissioning changes a hospice’s intended use of a new non-residential building from non-business to VAT exempt then the hospice will no longer be able to zero-rate the purchase or construction costs. The vendor / developer will have to charge standard-rated VAT which, because the hospice will be using the building for a VAT exempt activity, will be irrecoverable. The cost of new non-residential buildings will thus go up by 20%, though zero-rating may still be available on some items such as equipment and appliances designed solely for use by a disabled person.

However GP commissioning should not affect the construction or purchase of new residential hospice buildings. These can be zero-rated under the relevant residential purpose option and under this option the way the residential activities are funded does not matter.
The change of use rules

The VAT “change of use rules” enable HMRC to claw back some of the VAT saved through zero-rating if a charity’s use of a zero-rated building changes from the stated intention within the first 10 years from completion.

If a hospice has zero-rated a new building on the basis of relevant charitable purpose (non-business use), but the hospice’s own use of that building changes (within 10 years from completion) to VAT exempt as a result of GP Commissioning, then two things happen in law:

1. **Self-supply charge**: the hospice is deemed to make a taxable standard-rated supply of the building to itself. It must charge itself output VAT on this supply and pay that output VAT to HMRC. If the hospice is not VAT registered this may require it to register for VAT. The amount of output VAT due is one tenth of the VAT originally saved through zero-rating multiplied by the number of years left till the expiry of the 10 year deadline.

2. **Recovering the self-supply charge**: this output VAT is recoverable as input VAT if the change of use is to a taxable business activity. However if the change of use is to a VAT exempt activity, the output VAT cannot be recovered and the hospice ends up in effect repaying a part of the VAT originally saved through zero-rating back to HMRC.

**Example**

A charitable hospice zero-rated the construction of a new day hospice building on the basis of relevant charitable (non-business use). The building cost £1 million and the VAT saved through zero-rating was £175,000.

Three years later the funding for the use of that building switches to VAT exempt. The charity must pay output VAT to HMRC of: (£175,000 / 10) x 7 = £122,500

However if a hospice has zero-rated a residential building (relevant residential purpose) then as long as that use does not change from residential, a change in the funding regime does not trigger a VAT repayment under the change of use rules.

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1. Where the building is completed on or after 1 March 2011 the calculation is on a month basis
**Revenue & Customs Brief 29/07**

In order to zero-rate the purchase or construction of a relevant charitable purpose building that building has to be intended for use *solely* for non-business use. Even a small amount of intended business activity will, in strict legal terms, block zero-rating. Many grant or donation funded charities have at least a small level of business activity, for example putting on fundraising events where charges are made. Extra statutory concession 3.29 (“ESC 3.29”) allowed a charity to ignore up to 10% use of the building for business activities without blocking zero-rating. The 10% had to be calculated in one of a specified number of ways.

In 2007 HMRC announced in Revenue & Customs Brief 29/07:

| Charities that have obtained zero-rating for their new buildings or construction services under ESC 3.29 will no longer be liable for any VAT charge when there is a ‘change of use’ of the building within ten years of the zero rate having been obtained. |

ESC 3.29 was withdrawn with effect from 1 July 2010. In order to qualify for ESC 3.29 for constructions a “meaningful start” to construction services had to have commenced before 1 July 2010, and in the case of a purchase, a “meaningful” deposit had to have been paid to the developer before 1 July 2010.

From 1 July 2010 HMRC policy (as announced in VAT Information Sheet 08/09) is that the word “solely” incorporates a 5% de-minimis threshold below which business use can be ignored.

The announcement in Revenue & Customs Brief 29/07 still stands despite the withdrawal of ESC 3.29. This means if a hospice had relied on ESC 3.29 in order to zero-rate a new non-residential building on the basis of non-business use and that use switches to VAT exempt as a result of GP Commissioning, no VAT charge is triggered under the change of use rules.

However this does not apply to buildings where the meaningful start was on or after 1 July 2010. Any change in use of such a building to VAT exempt as a result of GP Commissioning will trigger the change of use rules.

The position with relevant charitable purpose buildings that were zero-rated on the basis of no business use (so ESC 3.29 was not required) prior to 1 July 2010 is unclear. HMRC suggested in Revenue & Customs Brief 29/07 these might also be able to ignore any change in use:

| Can only charities using the ESC benefit from the changes above? |

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This change may also affect the position of any charity that obtained zero-rating under Group 5, Schedule 8 of the VAT Act 1994, rather than the ESC. In the event of any ‘change of use’ of their building, the charity should contact HMRC at the above address for further advice.

In summary:

<table>
<thead>
<tr>
<th>Change of use of a zero-rated relevant charitable purpose building</th>
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<tbody>
<tr>
<td>Zero-rated on the basis:</td>
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<tr>
<td>Meaningful start / deposit before 1 July 2010</td>
</tr>
<tr>
<td>Meaningful start / deposit on or after 1 July 2010</td>
</tr>
<tr>
<td>No business use intended</td>
</tr>
<tr>
<td>Check with HMRC</td>
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<tr>
<td>Change of use rules apply</td>
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<tr>
<td>Relied on ESC 3.29</td>
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<tr>
<td>Change of use rules can be ignored</td>
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<tr>
<td>N/A – ESC 3.29 not available</td>
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<tr>
<td>Rely on 5% announcement</td>
</tr>
<tr>
<td>Change of use rules apply</td>
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Non-business contract

The term “business” is not clearly defined in the VAT legislation and the case law on what is business and what is non-business is complicated. However what is clear is that there has to be more than just providing a service under contract for the provision of that service to be a business activity. This is perhaps clearest where token fees are charged, for example peppercorn rents. However the case law goes further, suggesting that fees set below cost or even fees on a break even basis can be non-business in the right circumstances. Thus where NHS contract based fees do not cover the full cost of a hospice service, or even where they are on a break even basis, there is a possibility they are non-business, but it will depend on the wider circumstances.

HMRC operate a concession under which welfare services provided by a charity to distressed persons for the relief of their distress can be treated as non-business provided the fees cover less than 85% of cost. However HMRC specifically exclude services provided under contract to a local authority from the concession.

An important case law example of where subsidised fees were held to be non-business is the 2004 High Court case St Paul’s Community Project. As this is a High Court case it is binding on HMRC.

St Paul’s ran a nursery under the Sure Start programme for disadvantaged children for which it charged parents fees of between £85 and £90 per week. The fees were subsidised by a grant and set so as to enable the nursery to break even, the fees covering roughly 70% of nursery costs. The issue was whether or not the nursery was a business activity. The High Court found the activity was non-business and cited several factors, besides the subsidised fees, as having carried weight in this finding: the activity was undertaken for social reasons to support disadvantaged families, the admissions policy was skewed in favour of disadvantaged children and the fees were lower than those charged by commercial nurseries despite St Paul’s deliberately incurring higher costs to employ higher trained staff.

Cases where fees charged under contract to local authorities were found to be non-business include:

- Donaldson’s College (VTD 19258), a college for deaf children with fees charged to the child’s local authority
- Quarriers No 1 (VTD 20660), an epilepsy assessment centre charging fees to patient’s local authorities
- Quarriers No 2 (VTD 20670) a school for children with serious emotional difficulties charging fees to the child’s local authority

In summary, just because NHS funding switches to a contract basis, it should not be assumed the fee will become VAT exempt. However each situation may have to be
Hospice buildings, VAT and GP Commissioning

judged on its own merits, as the surrounding circumstances are crucial to the decision.