

**EXPLANATORY MEMORANDUM TO  
THE VALUE ADDED TAX (REDUCED RATE) ORDER 2006**

**2006 No. 1472**

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

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

2. **Description**

- 2.1 This Order amends Schedule 7A (Charge at Reduced Rate) to the Value Added Tax Act 1994 (c. 23) (“Schedule 7A”).
- 2.2 Article 3 amends the index to the reduced-rate supplies of goods and services at Part 1 of Schedule 7A by adding new Groups 8 (Contraceptive products) and 9 (Welfare advice or information).
- 2.3 Article 4 and the Schedule to the Order amend Part 2 of Schedule 7A by adding the new Groups 8 and 9 so as to apply the reduced-rate of VAT to supplies of contraceptive products and welfare advice or information.
- 2.4 The Committee is respectfully referred to the explanatory note to the Order for the specific detail.

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

None

4. **Legislative Background**

- 4.1 This Order has been made by the Treasury in exercise of their powers under sections 29A and 96(9) of the Value Added Tax Act 1994.
- 4.2 Section 29A(3) provides that the Treasury may by order vary Schedule 7A by adding or deleting from it any description of supply or by varying any description of supply for the time being specified in it.
- 4.3 Section 29A(4) provides that the power to vary Schedule 7A conferred by sub-section (3) may be exercised so as to describe a supply of goods or services by reference to matters unrelated to their characteristics and that, in the case of a supply of goods, those matters include, in particular, the use that has been made

of the goods.

4.4 Section 96(9) provides that the power to vary Schedule 7A includes a power to add to, delete or vary any notes to that Schedule.

## **5. Extent**

This instrument applies to all of the United Kingdom.

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

The Paymaster General, Dawn Primarolo has made the following statement under section 19(1)(a) of the Human Rights Act 1998:

In my view the provisions of the Value Added Tax (Reduced Rate) Order 2006 are compatible with the Convention rights.

## **7. Policy background**

7.1 The Government has introduced a reduced rate for supplies of contraceptive products, as defined, as part of its sexual health strategy to reduce the number of unplanned pregnancies and sexually transmitted infections. Reducing the rate of VAT to make such products cheaper is designed to support and encourage responsible choices in healthcare.

7.2 Following consultation with the charity sector after Budget 2005, it was recognised that a reduced rate for supplies of welfare advice and information would be beneficial to both providers of such services and their clients. The reduced rate will lower the cost of such advice to those vulnerable individuals and groups that would most benefit from it.

7.3 As part of Budget 2006 the Chancellor included contraceptive products and welfare advice and information in a list of reduced rates that would be in place by 1 July 2006.

## **8. Impact**

9.1 A Regulatory Impact Assessment in respect of the reduced rate of VAT for contraceptive products (which was published on 22 March 2006 and may be found at [www.hmrc.gov.uk/budget2006/index.htm#ria](http://www.hmrc.gov.uk/budget2006/index.htm#ria)) is attached to this memorandum. The new Group 8 will benefit the National Health Service by a reduction in costs.

9.2 A Regulatory Impact Assessment has not been prepared in respect of the reduced rate of VAT for welfare advice and information as it has only a negligible impact on business, charities or voluntary bodies. The impact on the public sector

is nil.

## **9. Contact**

Cathy Smith at HM Revenue and Customs Tel: 020 7147 0568 or e-mail: [cathy.smith2@hmrc.gsi.gov.uk](mailto:cathy.smith2@hmrc.gsi.gov.uk) can answer any queries regarding the reduced rate for contraceptive products.

David Bond at HM Revenue and Customs Tel: 020 7147 0058 or e-mail: [david.bond2@hmrc.gsi.gov.uk](mailto:david.bond2@hmrc.gsi.gov.uk) can answer any queries regarding the reduced rate for welfare advice and information.

# REGULATORY IMPACT ASSESSMENT

## 1. Reduced rate of VAT (5%) for contraceptive products.

## 2. Purpose and intended effect of measure

- **The Policy Objectives**

To reduce the price of contraceptive products, consistent with the Government's broader sexual health strategy of:

- promoting access to contraceptive products and advice where appropriate; and
- supporting people in making better, more informed, choices for the protection of their own sexual health.

In doing so, to increase access to the sexual health benefits of contraceptive products for people across the UK for whom price is currently an obstacle.

- **Background**

### ***Present VAT Treatment of Contraceptive Products***

VAT is not chargeable when a product is provided free of charge – for example by the NHS.

VAT is also not chargeable to individuals on prescribed contraceptive products supplied by a pharmacist (such as the contraceptive pill),<sup>1</sup> nor where a contraceptive product is fitted or administered in a hospital or clinic.<sup>2</sup>

However, VAT is chargeable at the standard rate (17.5 per cent) on all other sales of contraceptive products, including on all sales made 'over the counter' by way of retail, internet sales, or sales made from vending machines.

### ***Government Strategy on Sexual Health***

In its November 2004 White Paper '*Choosing Health: Making health choices easier*', the Government announced £300 million would be allocated over three years to transform and improve sexual health. More recently sexual health has been designated one of the top NHS priorities for 2006-07.

Measures announced to date include a high-profile national campaign aimed at increasing awareness of sexually transmitted infections (STIs) and promoting the protective benefits of condoms. The Government has also committed funding for the improvement and upgrading of NHS genito-urinary

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<sup>1</sup> This supply is zero-rated under item 1, Grp 12, Schd 8, VAT Act 1994.

<sup>2</sup> This supply is exempt from VAT under item 1 or 4, Group 7, Schd 9, VAT Act 1994

medicine (GUM) and contraceptive services, and for a National Chlamydia Screening Programme.

### ***The Market for Contraceptives***

Sales of condoms account for 99 per cent of all ‘over the counter’ sales of contraceptives<sup>3</sup>. Therefore the major impact of any VAT reduction will be in relation to the sale of condoms. Analysis in this RIA therefore focuses on condoms, in relation to which, research<sup>4</sup> prepared for the Department of Health in January 2005 found that:

- An estimated 126 million condoms are purchased or made available annually in the UK. Within this, 60.7 per cent are purchased from retail outlets, 7.9 per cent are purchased from vending machines, 1.2 per cent are purchased from internet retailers and 30.2 per cent are provided free of charge by the NHS and others.
- Condom prices vary from approximately 23p to £2.13. Average (mean) retail price is 60-65p, while the average (mean) price from vending machines is 67p - £1.
- Larger supermarkets and pharmacy chains generally dominate the retail market for condoms. However, condoms are also sold through outlets such as petrol stations, convenience stores and vending machines, where competitive pressure on price may be less significant.
- The sample of manufacturers and retailers surveyed believe that price, accessibility and safety are the key factors of importance to consumers when purchasing condoms. Price was thought to be a particularly significant factor for some of the most vulnerable sexual health risk groups, and any price reduction could therefore have its major impact on condom purchase and use amongst these groups.
- Assuming that a VAT reduction from 17.5 per cent to 5 per cent was passed on in full within prices, sales of condoms could increase by up to one million for two years. However a price reduction is likely to achieve its best results (in terms of increasing condom use) when introduced alongside broader measures designed to promote and improve access to condoms.

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<sup>3</sup> All analysis in this section of the RIA is reproduced from *OTC Contraceptives – UK Market Study* - A Report for Department of Health carried out by Sambrook Research International (31 January 05). This included desk research and interviews with a small sample made up of 27 manufacturers, retailers and other relevant groups. Where relevant, these data will be published by Department of Health.

<sup>4</sup> *ibid*

- ***Rationale for Government Intervention***

The Government has committed funding for a range of measures designed to improve and modernise sexual health services, and to support people in making better-informed choices for their own sexual health. Measures enacted or planned include: improved access to NHS sexual health and contraceptive services; a National Chlamydia Screening Programme; and a health education campaign aimed at increasing awareness of STI risks.

As well as the benefits to be achieved in terms of an individual's health and wellbeing, there is also a broader economic argument to support Government investment in sexual health and contraceptive services. Research by FPA (Family Planning Association) suggests that for every £1 spent on providing wide availability to good contraception there is a corresponding saving of over £10<sup>5</sup>.

The Government is also aware of the views of the Independent Advisory Group for Sexual Health and HIV, and a number of other expert groups, which have supported a VAT reduction as an effective part of the Government's sexual health strategy.

The Government believes that any VAT reduction would be most effective alongside broader measures - both from Government and elsewhere - aimed at promoting awareness of sexual health risks and contributing to the prevention of STIs. At the same time, sexual health awareness-raising measures, such as the planned nationwide campaign, will be most effective where individuals can obtain access to affordable contraceptives.

A VAT reduction and broader measures to raise sexual health awareness should therefore be mutually enhancing, and a wide range of organisations - including the NHS, sexual health charities and manufacturers and retailers of contraceptive products - have a role to play in securing improvements in sexual health.

Retailers of condoms have campaigned for a VAT reduction, and a number of retailers have already undertaken to pass any such VAT reduction on to customers within retail prices. The Government believes that all suppliers should follow this course of action and will monitor the position closely.

Further, the VAT reduction, when considered alongside broader Government measures to raise awareness and promote the sexual health benefits of condoms, is likely to increase sales of condoms. On this basis, the Government believes that it is reasonable to expect condom manufacturers and retailers - who can expect to benefit from increased sales - to sponsor or

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<sup>5</sup> Mcguire A and Hughes D (1995) cited in Independent Advisory Group on Sexual Health and HIV Response to New Developments in Sexual Health and HIV AIDS Policy (February 2006)

undertake other initiatives to support sexual health - for example through the increased provision of sexual health information, or by tackling access to condoms or information among identified sexual health risk groups. The Department of Health will explore with manufacturers and retailers the constructive role they can continue to play in improving sexual health alongside the Government's strategy.

### 3. Consultation

- **Within Government**

Discussions between HM Treasury, HM Revenue and Customs and Department of Health about potential interactions between the VAT position and the Government's strategy to transform and improve sexual health.

- **Public Consultation**

The Government is aware of the views of a range of stakeholders and expert groups, which have supported a reduction in the VAT rate chargeable on contraceptive products. These include the Independent Advisory Group on Sexual Health and HIV, sexual health charities, the MPs who are signatories to House of Commons early Day Motion 687, and a number of the main manufacturers and retailers of contraceptive products.

VAT on condoms is one of a number of issues relating to sexual health discussed in general terms with a sample of manufacturers and retailers by Sambrook Research International in the course of preparing a market study for the Department of Health.<sup>6</sup> In the course of this research, the vast majority of this sample made clear that they would pass on any VAT reduction to customers with prices, and a majority also indicated that, in addition to a price reduction, they would undertake further initiatives in support of the Government's broader strategy to transform and improve sexual health.

### 4. Options

Under the European agreements that govern the VAT system, it is not possible to entirely remove VAT from all contraceptives. It is however possible to introduce a reduced rate of VAT of 5 per cent. On that basis, available options include:

- i. Do Nothing.*

The standard rate of VAT (17.5 per cent) would continue to be chargeable on all contraceptive products other than those that are (i) prescribed or (ii) administered or fitted in the course of medical care or treatment.

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<sup>6</sup> See footnote 3

- ii. ***Five Per Cent Rate for Male and Female Condoms Only.***  
This would reduce the VAT payable on an estimated 99 per cent of contraceptive products sold ‘over the counter’, but not on any other product other than condoms.
- iii. ***Five Per Cent Rate for all Contraceptive Products.***  
This would reduce the VAT payable for all contraceptive products on which VAT is presently charged at 17.5 per cent - including male and female condoms, and (non-prescribed) diaphragms, caps and emergency contraception sold over the pharmacist’s counter.

## 5. **Costs and benefits**

- ***Sectors and Groups Affected***

The measure has potential benefits for a large number of people. The greatest potential benefit is for those people who wish to purchase and use contraceptives, but for whom price is currently an obstacle.

There will also be an impact on all organisations that purchase or sell contraceptive products – such as retailers, vending machine operators, internet retailers, the NHS and other health care providers.

None of the identified options would have any equality impact.

- **Benefits**

- i: Do nothing***

- There would be no loss of tax revenue and no new compliance costs for any supplier of contraceptive products.

- ii: Five Per Cent Rate for Condoms Only***

- The Government expects that all retailers and manufacturers of contraceptive products will pass the benefit of any VAT reduction onto their customers in the form of lower prices. This should lead to reductions in price for individuals and organisations (such as the NHS) that purchase condoms. Using the average prices quoted above, customers could expect the price of a packet of three condoms to fall by approximately 20p, although this will of course vary according to the VAT-exclusive price charged by the supplier.

- This VAT reduction should therefore increase access to condoms for people that wish to purchase and use them, but for whom price is currently an obstacle. In doing so, the VAT reduction will enhance and complement other Government measures aimed at raising awareness of sexual health risks, promoting access to sexual health advice, and supporting people in making better choices for the protection of their health.



A VAT reduction that contributes to increased access to, and usage of, condoms could impact upon the incidence of STIs and unplanned pregnancies amongst particularly vulnerable groups. As well as providing potential benefits in terms of individual's health and wellbeing, and the reduction of broader health inequalities, this could produce savings in NHS treatment costs. As detailed above, analysis suggests that every £1 spent on contraception produces a corresponding saving of over £10.<sup>7</sup>

It is likely that a VAT reduction, when considered alongside the Government's broader sexual health measures, will benefit condom manufacturers and retailers by increasing their sales. In return for this benefit, the Government believes that it is reasonable to expect manufacturers and retailers to play a major part in supporting sexual health improvements. The Department of Health will discuss with the major manufacturers and retailers the further sexual health benefits that might be achieved through industry initiatives, which might be undertaken alongside the planned Government measures.

Restricting a reduced VAT rate to condoms would recognise that fact that condoms are commonly regarded as the most effective contraceptive safeguard against STIs. It is therefore the Option that could provide the most effectively targeted benefits in relation to the prevention of STIs.

***iii: Five Per Cent for all Contraceptive Products.***

This option would result in the same general benefits, and the same beneficiaries, as are outlined in respect of Option ii. It would however also remove any risks associated with different retailed contraceptive products being treated differently for VAT purposes – for example, the risk that different VAT treatment might impact on customer choice, or contribute to VAT accounting complexities for retailers.

- **Costs**

***Revenue costs***

***i: Do nothing.***

The Government's broader strategy to promote informed decision making in relation sexual health may be less effective, especially in relation to those people for whom price is currently an obstacle to accessing contraceptives.

***ii: Condoms Only.***

The fiscal cost of this option is approximately £6 – 7 million per year.

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<sup>7</sup> see footnote 2

**iii: Reduced Rate for all Contraceptive Products.**

The fiscal cost of this option is approximately £10 million per year.

**Compliance costs for businesses**

The tax compliance burden associated with any change (Options ii and iii) will fall on retail, internet or vending machine suppliers, both large and small. Most – if not all – of this cost is likely to be one-off and could arise from:

- the need for retailers to make changes to their Epos systems and VAT retail schemes;
- the need for vending machine operators to make adjustments to their machines; and
- the complexity for suppliers that might – under option ii - have to apply different VAT rates for contraceptive products.

The overall cost to businesses is expected to be below £3m. In relative terms large multiple chains will be less affected than the small independent chemist. For large multiple chains (such as supermarkets) the cost will not be significant, while for smaller suppliers the estimated costs are set out in section 6: ‘The Small Firms Impact Test’ and, we estimate, should not be higher than £0.7m in total.

When considering any costs, it is fair to recognise that most affected suppliers will already apply a 5 per cent VAT rate for women’s sanitary products, and therefore will have the necessary systems in place to account for sales made at the 5 per cent rate of VAT. This may well reduce any costs associated with this VAT change. Further, any costs will be offset wholly or in part by the revenue gained from additional sales generated by a VAT reduction.

**6. Small Firms Impact Test**

Our assessment of the compliance costs associated with a reduced rate of VAT is set out in the table below. The difference in compliance costs between the two reduced rate options (Options ii and iii) is considered to be insignificant.

SET UP COSTS		
Independent chemists	Total	£0.11M
	Each	£15
Vending Machines	Total	£0.58M
	Each	£10
Internet Suppliers	Total	£0.01M
	Each	£10

7. **Competition assessment**

*i. Do nothing.*

No competition effect.

*ii. Condoms Only.*

Will provide a VAT benefit for the major part of the retailed contraceptive market. However, it is unlikely that price considerations alone influence consumers to choose one form of contraception over another.

*iii. All contraceptive products.*

No competition effect anticipated.

8. **Enforcement, Sanctions and Monitoring**

If non-compliance is established this will be dealt with under powers given in VAT Act 1994.

The Government expects all manufacturers and retailers to pass on any VAT reduction within prices, and, will closely monitor the effects of this tax change on prices. This will inform our review of the proposed measure, which will take place one year after the changes have taken place.

9. **Implementation and Delivery Plan**

Guidance for businesses affected by the proposed VAT change will be published by HMRC in the form of a Budget Note, issued on 22 March 2006. HMRC have also publicised the proposed VAT change through their advice and contact centres for businesses and the public.

The measure will be implemented by statutory instrument during 2006 to come into effect, subject to Parliamentary approval, on [1 July 2006]. This will allow a sufficient lead-in for manufacturers and retailers to prepare for the price changes that should result from a VAT reduction.

10. **Post Implementation Review**

The Department of Health will discuss with manufacturers and retailers the expected impact of this proposed VAT reduction in terms of reduced prices for customers, and other industry initiatives designed to support sexual health and improve access for those that require contraceptive products.

The Government will monitor the impact on prices and access to contraceptive

products, and the response of the industry to the VAT reduction:

- as part of its post-implementation review, which will take place within one year after the proposed changes have been implemented; and
- in the course of its ongoing strategy to transform and improve sexual health.

## 11. Summary and Recommendation

### Option iii Recommendation

Costs	Benefits
<p>Revenue cost to Exchequer of approximately 10m p.a.</p> <p>No significant costs for major retailers</p> <p>Estimated overall one-off set up costs for smaller businesses of no more than 0.7million</p> <p>However any costs will be wholly or partly offset by increased revenue generated by increased sales.</p>	<p>Mutually enhance existing Government strategy to promote sexual health benefits of contraceptive products, and informed decision making.</p> <p>Benefits to be expected in individual well-being if contraceptive products are more widely available for those that wish to use them, and for whom price is presently an obstacle</p> <p>Research suggests that for every £1 spent on providing wide availability to good contraception there is a corresponding saving of over £10.</p>

This represents a cost-effective proposal, fully supported by (and supportive of) the Government's sexual health strategy, including its promotion of the sexual health benefits of condoms. The evidence presented above supports this recommended option on the basis of:

- the sexual health benefits of condoms in the reduction of STIs and unplanned pregnancies;
- the expectation that a VAT reduction will be reflected in reduced prices and will complement existing Government measures to promote sexual health and informed decision-making; and
- the suggestion that the price of contraceptive products is currently an obstacle to access to, and use of, contraceptive products for certain identified sexual health risk groups.

While the above benefits might be obtained through a VAT reduction for

condoms only, that option is not recommended on the basis that there may be risks – however slight – associated with the different VAT treatment of different contraceptive products available by retail.

**Contact Point**

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**REGULATORY IMPACT ASSESSMENT**

**Reduced Rate of VAT (5%) for Contraceptive Products**

**Statement of Ministerial Approval**

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

Signed by the responsible Minister

Dawn Primarolo  
Paymaster General

Dated: 14 March 2006