


VAT reform proposals for the public sector - government departments, NHS and some other public bodies

The Treasury is looking to simplify and extend VAT recovery for 'section 41' organisations, the consultation remains open until 18 November 2020.

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HM Treasury recently issued a consultation paper, '[VAT and the Public Sector: Reform to VAT refund rules](#)' which is relevant for government departments and certain other public organisations such as the NHS, although it doesn't directly affect local authorities. The consultation remains open for responses until 18 November 2020.

The current position

Government departments, the NHS and some other public organisations¹ are restricted as to the extent they can recover from HMRC the VAT which they incur on goods and services, even when that is for their 'non-business' activities such as their main public duties, and not for any commercial activity. Broadly speaking, these 'section 41' organisations can only recover VAT which they incur on services they buy in for their non-business activities if those services fall within one or more of 76 categories, known as Contracted Out Services or 'COS'. In general, they can't recover VAT they incur on goods which they use for their non-business activities.

This differs from the position for local authorities and some other specified types of public body, such as fire and police authorities². Broadly speaking, those 'section 33' organisations can recover VAT they incur on goods and services which they use for their non-business activities, and don't need to check if the services fall within a COS category or not. So there is this material difference in the VAT recovery position between (i) local authorities and other 'section 33' organisations, and (ii) government departments, the NHS and other 'section 41' organisations.

The Treasury's reform proposal

In its consultation the Treasury's preference is to change this, so as to permit full refunds of the VAT incurred on all goods and services incurred for the non-business activities of 'section 41' organisations, including government departments and the NHS. This would give them more or less the same VAT recovery powers which local authorities and other 'section 33' bodies enjoy. The Treasury refers to this in its consultation as the 'Full Refund Model'.

This Full Refund Model wouldn't change the VAT recovery position for business activities carried out by 'section 41' organisations. So for example, they could still have VAT recovery blockage in relation to their VAT exempt business activities.

Intention and impact

The Treasury are looking to simplify and extend VAT recovery for 'section 41' organisations including government departments and the NHS. They estimate that currently these 'section 41' organisations may be incurring £10-£15 billion of irrecoverable VAT per annum. Its

preferred Full Refund Model would see the end of the COS regime, which can seem somewhat impenetrable to those not steeped in its intricacies. It would also allow 'section 41' organisations to recover VAT on goods, as well as services, for non-business use. But this increased VAT recovery would likely see a commensurate drop in government top up funding to cover current VAT recovery shortfalls.

Timing

As mentioned above, the Treasury's consultation remains open until 18 November 2020, and so it may be well into 2021 before any substantive changes begin to take place. In its paper, the Treasury say that it might take two to three years to implement this kind of reform to the public sector VAT recovery system. But this is a point that should be on the radar for those dealing with financial matters for government departments, NHS entities and other 'section 41' organisations.

If you have questions or would like to discuss this, please contact [Peter Ware](#) or [Andrew Noble](#).

¹ Along with certain other public bodies (but not local authorities), together often referred to as "section 41" organisations for VAT purposes, following section 41 Value Added Tax Act 1994.

² Together often referred to as "section 33" organisations, following section 33 Value Added Tax Act 1994.

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