


# VAT reform proposals for the public sector - NHS and government departments

HM Treasury recently issued a consultation paper, [VAT and the Public Sector: Reform to VAT refund rules](#) which is relevant for the NHS and government departments. The consultation remains open for responses until 18 November 2020.

 29 September 2020

HM Treasury recently issued a consultation paper, [VAT and the Public Sector: Reform to VAT refund rules](#)<sup>1</sup> which is relevant for the NHS and government departments. The consultation remains open for responses until 18 November 2020.

## The current position

The NHS and government departments<sup>2</sup> are restricted as to the extent they can recover from HMRC the VAT which they incur on goods and services for their 'non-business' activities such as their main public duties. Broadly speaking, these 'section 41' organisations can only recover VAT 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 authorities<sup>3</sup>. Broadly, these '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) the NHS, government departments 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 during the course of non-business activities for 'section 41' organisations, including the NHS and government departments. 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 exempt business activities.

## Intention and Impact

The Treasury are looking to simplify and extend VAT recovery for these 'section 41' organisations including the NHS. They estimate that currently the NHS and government departments 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.

If the Full Refund Model goes ahead there will be issues for the NHS to consider, for example:

- Would the Full Refund Model mitigate current adverse VAT problems that arise if NHS commissioners contract with private sector prime providers who in turn subcontract with the NHS?
- How would a fair playing field be maintained if NHS trusts /foundation trusts can recover all VAT incurred in providing NHS services but the independent sector cannot recover any such VAT?

## 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. The Treasury say that it might take two to three years to implement this kind of reform to the public sector VAT recovery system.

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

---

<sup>1</sup><https://www.gov.uk/government/publications/vat-and-the-public-sector-reform-to-vat-refund-rules>

<sup>2</sup>Along with certain other public bodies, together often referred to as “section 41” organisations for VAT purposes, following section 41 Value Added Tax Act 1994.

<sup>3</sup>Together often referred to as “section 33” organisations, following section 33 Value Added Tax Act 1994.

## Contact



Andrew Noble

Partner

[andrew.noble@brownejacobson.com](mailto:andrew.noble@brownejacobson.com)

+44 (0)121 237 3952

---

## Related expertise

### Sectors

Government

Health

Local government