VAT and the public sector: reform to the VAT refund rules: a call for evidence

Indirect Tax

07 January 2021

The CIOT has responded to HM Treasury's call for evidence: 'VAT and the public sector: reform to VAT refund rules' (see tinyurl.com/y3mvposj) to look at ways in which the input VAT recovery and VAT accounting could be simplified for public sector organisations such as government departments, devolved administrations, the NHS and Highways England.

The call for evidence arose as a result of recommendation 16 in the Office of Tax Simplification's 2017 report Value Added Tax: Routes to Simplification (see tinyurl.com/y5wqj77o), which stated that HMRC should look at ways of enhancing its support to other parts of government on VAT issues affecting their operations.

Current VAT recovery position

The organisations listed in Value Added Tax Act (VATA) 1994 s 41 have a limited input VAT recovery position restricted to the VAT incurred on the purchase of outsourced services to deliver the organisations' statutory non-business activities; these outsourced services are known as 'contracted out services' (see tinyurl.com/y6amv2b7). Section 41 was introduced so that the cost of VAT could be ignored as a factor when making outsourcing decisions.

Full Refund Model

HMT's preferred proposal in the call for evidence is to extend the scope of s 41, which was also the preferred option of s 41 organisations based on initial consultations. The proposed extension of s 41, referred to as the 'Full Refund Model', would allow input VAT to be recovered on goods as well as services in relation to the costs of delivering non-business activities. The alternative simplification options

were to scrap the s 41 refund scheme entirely (and have all costs including VAT funded centrally by government), or for outsourced suppliers to zero-rate their supplies to s 41 organisations. However, neither of these alternatives were considered by HMT to fulfil the balance of simplification compared to encouraging outsourcing. The Full Refund Model would grant the same input VAT recovery position as local government and other organisations listed in VATA 1994 s 33 on the purchase of goods and services used for non-business activities, and this would also bring simplification to the VAT recovery position when s 41 and s 33 organisations worked on joint projects.

The CIOT's views

The CIOT supports HMT's proposal to extend the VAT recovery position for s 41 organisations to HMT's preferred Full Refund Model, subject to any further views presented by the affected organisations in the call for evidence. The contracted out service rules are complex, lengthy and can cause a considerable administrative and financial burden for both the s 41 organisations, and the suppliers submitting tenders for contracts, which disproportionately impacts smaller suppliers when bearing the costs of resource and professional VAT advice on what may well be a one-off contract.

The CIOT would also like to see the position on partial exemption for s 41 organisations to be clarified. Will it change to a similar position to local governments and organisations listed in s 33, or will there be no extension to the current position? The call for evidence also asked for feedback on the timeline of the implementation of any simplification changes. The CIOT would like to see any changes carried out at an early stage, subject to feedback from s 41 organisations.