How to: manage VAT refunds for temporary staff in the NHS
Nick Chronias from Beachcrofts LLP answers your questions on the issue of VAT and temporary staff in the NHS.

Following a number of queries from NHS organisations relating to the issue of VAT and temporary staff, the NHS Employers organisation asked Nick Chronias from Beachcrofts LLP to answer some of the most commonly asked questions on the subject.

All VAT-registered businesses that supply services to the NHS will apply a standard rate of VAT (currently 20 per cent). This includes agencies who supply temporary staff, such as doctors and nurses. NHS organisations have no standard exemption from VAT, however there are two different ways you can recover all or some of the VAT you pay.

This document is an introduction to VAT and how this applies to the NHS. It does not detail all the reliefs and exemptions that apply or address the position of supplies made by the NHS. Detailed advice should be taken before a course of action or omission is pursued.
Introduction
All services the NHS procures from VAT-registered businesses will be a standard rated supply for the purposes of VAT. This means that the supplier must charge VAT at the standard rate, currently 20 per cent. If the contract does not mention VAT, the cost will be inclusive of VAT, but most contracts normally state that the cost is exclusive of VAT, so the VAT cost is on top.

A business must register for VAT and start charging VAT once its VATable supplies for the last 12 months or next 30 days (expected) reach the VAT registration threshold, which for the tax year 2011/12 is £73,000. Your suppliers will be able to tell you if they are VAT registered.

Are supplies to the NHS non-business?
Although VAT is only charged on business supplies, almost all supplies, even to the NHS, are seen as being in the course of business. Following a Treasury Direction, VAT on nursing services purchased for the provision of healthcare are seen as non-business services and can be refunded. However, doctors do not fall under this Direction.

Do NHS trusts have any exemption from paying VAT?
NHS trusts have no blanket exemption from paying VAT. However, if the supplier and recipient of the supply are both NHS trusts in England then they are within the same divisional registration. This means that supplies between the two are outside the scope of VAT and VAT does not need to be charged.

Does this requirement to charge VAT (and for the NHS trust to pay VAT) extend to the supply of services for staff?
Yes. VAT is due on the supply of services, one example being the supply of temporary staff such as doctors or nurses.

Is there any way NHS trusts can get back this VAT or is it a real cost to them?
There are two different ways in which NHS trusts can recover all or some of this VAT:

VAT at a glance
- Most services are VATable.
- Supplies of temporary workers are VATable.
- NHS trusts have no automatic exemption from VAT.
- NHS trusts have a special statutory VAT recovery system which helps for temporary nurses but not doctors.
- NHS trusts should not enter into tax avoidance schemes and there is specific Department of Health guidance stating this.
HM Revenue & Customs and HM Treasury are keen to encourage efficiency savings and believes that part of the way this can be achieved is through outsourcing of services. However, they do recognise that to the extent the outsourcing entity has to charge VAT that cannot be recovered this can wipe out any efficiency savings. A statutory system has been introduced to address this issue, but only in certain specified areas. From time to time a Treasury Direction is published listing the various services which, when outsourced, qualify for a VAT refund. Any such VAT incurred by an NHS trust (or indeed certain other specified government departments) will be refunded by HM Revenue & Customs, assuming the VAT was incurred for non-business purposes. (Any activities carried out on a statutory basis or for no consideration will qualify as for non-business such as the provision of healthcare.)

If the NHS trust incurred the expenditure (which carried a VAT cost) solely so that it would be itself making VATable supplies, then that NHS trust would be able to recover all of the VAT it paid (its input VAT). If, say, 50 per cent of its onward supplies were VATable, then it would be able to recover 50 per cent of its input VAT. However, purchasing services that carry a VAT charge in order to provide its traditional medical function for the public will not create any such recovery.

What services does the Treasury Direction extend to?
It covers a wide range of services, from laboratory services to laundry services and from catering to distribution services. The full detail of the Direction can be accessed at [insert hyperlink].

Does this Treasury Direction extend to the supply of temporary staff?
The Treasury Direction applies to the supply of nursing services but not to the supply of doctors. Nursing services is quite widely interpreted by HMRC and extends to the “provision of nursing services of agency nursing staff whether on an agency commission basis or otherwise”.

Doesn’t this mean that there is a VAT cost on acquiring the services of temporary doctors (not as employees)?
Yes. However, HM Revenue & Customs’ view is that when calculating the amount of the funding provided to NHS trusts, one element factored in is that certain services paid for by NHS trusts (and not just the services mentioned here) will be VATable and such VAT will be a true cost to the NHS trust in question.

Can you give an example of where an NHS trust would be able to recover VAT under item (b) above?
If, for example, an NHS trust rents out a unit in a hospital to a florist and charges that florist VAT on top of the rent (by opting to charge VAT) it can recover any related VAT it incurred such as legal fees and estate agent’s fees on such letting.

Can’t we just hire the workers as our employees?
From a VAT point of view, yes. Paying employees does not carry a VAT charge. However, NHS employers should remember that it will just be substituting one set of risks/costs (in respect of VAT) for another (as an employer).
But will they be employees and what does that mean?
Where individuals are engaged by an NHS body on an ad hoc basis, they will be employees at the very least for the duration of their assignments. That general model of engaging a bank of “temporary staff” then gives rise to all the potential risks and responsibilities for an employer, including:

(a) claims for unlawful discrimination
(b) claims for unfair dismissal (where, as often happens, the bank worker has a year’s service for unfair dismissal purposes)
(c) dealing with disciplinary and grievance issues
(d) potential claims under the Part-time Workers Regulations claiming comparable treatment with “substantive” employees.

It may well be that the benefit of the VAT saving is outweighed by the employer responsibilities set out above.

Surely there are some clever ruses to get round this VAT?
As time progresses, any such schemes will become more and more convoluted and expensive and rarely are they guaranteed to work. As noted in the last question, part of the funding takes into account this VAT cost. If this expected VAT could be avoided then the NHS trust would, at first sight, look to be better off. However, this saving for the NHS trust would be at the expense of the tax receipts. It is therefore important to consider the way in which such a scheme causes leakage from the NHS/HM Revenue & Customs circle.

Is there any guidance on tax avoidance schemes?
The tax leakage caused by tax avoidance schemes was recognised in 1997 and reported to all NHS trusts at that time by Richard Douglas. A copy of Richard Douglas’ letter of 10 November 1997 can be accessed on the NHS Employers website.

How important is the Richard Douglas letter, bearing in mind how old it is?
It is understood that this letter is still an accurate representation of policy and cannot be ignored. If such a policy is implemented, following use of a tax avoidance scheme, a claw-back should be expected. If this happens, the only people winning will be the tax advisers charging their fee.

Do NHS trusts have any discretion here?
Public bodies should NOT enter into any tax avoidance schemes.

Where is the dividing line between tax avoidance and taking normal tax advice?
The Richard Douglas letter touches upon this but it is more a matter of gut feeling than of any written formula. This has been developed over time by the courts and, if you are in doubt, legal/tax advice should be taken. In addition, and notwithstanding the above, thought should be given to tax structuring dominating the way in which services are provided. For example, as explained above, is it worth saving VAT at the expense of incurring greater employment risks?
Isn’t there a concession for the hire of staff?

There was a concession which helped on the hire of staff. It used to say that where the fee was £110 (being £100 for the doctor’s salary and £10 for the agency fee) that VAT was only due on the £10 agency fee. Unfortunately, this was withdrawn with effect from 1 April 2009, except that it still applies in very narrow circumstances. But to apply the first step is for the agency in question to not charge any profit fee. As will be appreciated, any commercial agency will therefore normally fall at this first hurdle.

What about the case of Reed Employment v HM Revenue & Customs?

This case, which was decided in March 2011, is an important case in this area, but this was only a first-tier tribunal decision and it is expected that HM Revenue & Customs will probably appeal this. Reed Employment carries on business in the temporary job market and introduces temporary workers to engagers for a fee. The big advantage following the Reed case was that VAT was charged only on Reed’s commission and not on the workers’ charges (i.e. from a VAT point of view, a return to the situation before the extra statutory concession referred to above was closed).

In Reed, the tribunal held that the economic substance of the arrangements was key, as opposed to just the exact terms of the contract itself. Because Reed never had control over the day-to-day work of the temporary workers, it couldn’t supply their services to the engager (as distinct from introducing them). Therefore, the true nature of the service being supplied by Reed was one of introductory services (together with some ancillary services). Reed’s own commission was the only item on which VAT was due.

The key phrase in the tribunal decision is: “Whereas Reed undertakes to offer the temp worker opportunities to work, the temp worker is expressly under no obligation to accept any such offer. There is no obligation on the temp worker to provide any services to anyone. It is only after the temp worker has started work at the client’s premises that the conditions of work apply.”

It is understood that, quite apart from any appeal, HMRC does not, at present, accept that the case is good in the light of current employment law, so the case would be treated with considerable caution.

What about employment law issues?

The difficulty with such an approach is if the workers weren’t employees of someone like Reed could they become employees of the engager? An absence of employment with Reed won’t automatically create an employment relationship with the engager but it does bring it one step closer. There are cases where an agency worker has been held to be an employee of the engager/client, particularly where the worker has continuously worked at the client for a long time. A significant safeguard against this risk is to ensure the agency has clear contracts with its workers setting out the various rights and obligations between them.

It is dangerous to consider VAT in isolation ignoring other issues such as employment. When looking at temporary workers, from an employment law/NHS regulatory point of view, it is normally key to ensure the workers do not become employees of the NHS trust in question.

I think we’ve had such a situation in the past. Can we get back that VAT?

If so, and you paid VAT where you didn’t need to, then subject to certain time limits you may be able to claim back such overpaid VAT from your supplier. You should contact your supplier and/or take legal advice as to the terms of your contract with them. If you received a refund from HM Revenue & Customs through, for example, the Treasury Direction, you won’t get double recovery.
Something for the future?
For some time, HM Revenue & Customs has been under an EU obligation to introduce an exemption from VAT for services supplied by what are known as “shared service centres”. Following pressure from the EU (VAT is an EU tax) HM Revenue & Customs is now consulting on how to implement this, but at the very least it seems likely that this will need to be done on a not for profit basis. It is expected this will be introduced with effect from April 2012.

Beachcroft LLP (12 August 2011)