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HMRC'S CHANGE IN STANCE ON VAT GROUPING IN THE CARE SECTOR

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On 24 April 2025, HMRC published Revenue & Customs Brief (RCB) 02/25, signalling a significant and unexpected change in its approach to VAT grouping structures used by state-regulated care providers. HMRC now explicitly views these structures, which involve incorporating an unregulated entity into the supply chain to recover VAT on costs, as a form of tax avoidance. This contradicts previous HMRC acceptance of these arrangements and is causing considerable concern and disruption within the care sector and for local authorities and ICBs.

HMRC will use existing powers to refuse new VAT group applications and remove entities from existing groups involved in these structures. While these actions are stated to be prospective, the long-standing nature of these arrangements and previous HMRC reviews raise questions about potential challenges and the implications for historical VAT savings.

HMRC'S NEW POSITION

HMRC's core message in RCB 02/25 is that they no longer accept the efficacy of certain VAT planning structures in the care sector.

It explicitly states: "HMRC has identified a growing use of VAT grouping structures by state-regulated care providers to recover VAT on costs that relate to supplies of welfare services that would otherwise be exempt from VAT."

HMRC considers these structures, which incorporate an unregulated entity between the state-regulated provider and the local authority or ICB, to be a form of tax avoidance.

THE TARGETED STRUCTURE

The structure involves a state-regulated care provider and a non-state-regulated entity within the same VAT group.
·In the VAT group:

- **The VAT-exempt supplies between the regulated and unregulated companies within the VAT group are disregarded for VAT purposes.**
- **The unregulated company charges VAT to the local authority or ICB.**
- **The VAT recovery by the regulated company is determined by looking through the unregulated company to the supplies it makes out of the VAT group (to the local authority or ICB).**
- **As the unregulated company supply to the local authority or ICB VAT is standard rated, the VAT costs of the regulated company are recoverable.**
- **This arrangement effectively allows VAT recovery on costs related to supplies to local authorities and ICBs, while supplies to private individuals remain exempt.**

HMRC'S ACTIONS

HMRC will take immediate action using existing powers.
It will "make full use of its powers to protect VAT revenue and, where necessary, refuse new VAT group registration applications that are designed to implement and facilitate these VAT grouping structures." (RCB 02/25)

HMRC is launching a programme to review and investigate existing VAT groups suspected of using these structures.

Where avoidance is determined, HMRC:
"will exercise its Protection of the Revenue powers under Section 43C(1) of the Value Added Tax Act 1994 to remove the relevant parties from VAT groups." (RCB 02/25)

These actions to refuse new applications and remove entities from existing groups are stated to be prospective.

CONSEQUENCES OF DEGROUPING

- Supplies between the regulated and unregulated companies will no longer be disregarded.
- The regulated company will be making VAT-exempt supplies to the unregulated company of care/welfare services. The VAT recovery by the regulated company is no longer determined by looking through to the unregulated company's supplies but by the supplies it makes itself, which are VAT-exempt. It will lose entitlement to reclaim VAT costs.
- The unregulated company will not be charged VAT by the regulated company but must still charge VAT on services to local authorities and ICBs.

SURPRISE AND LACK OF CONSULTATION

There has been no change in legislation or consultation, and the change was not signalled to representative bodies such as JVCC, CTG, CIOT, CIPFA, or the HfMA.

PREVIOUS HMRC STANCE AND SECTOR RELIANCE

- These structures have been used for a considerable time and were, in many cases, known to and not previously challenged by HMRC.
- In numerous cases, it has either been approved in writing by HMRC or reviewed during a routine VAT inspection, with no previous concerns raised about tax avoidance.

DISTINCTION FROM ABUSIVE SCHEMES

- Some advisors have differentiated their specific arrangements from potentially more aggressive schemes.
- They emphasise that their restructuring "Is not simply a means of enabling VAT recovery and is fully supported by our commercial rationale."
- They further suggest that HMRC's approach is "unnecessarily "heavy-handed and seeks to "conflate all forms of contract restructuring."

RISK TO HISTORICAL SAVINGS (LIMITED BUT POSSIBLE):

- While HMRC states actions are prospective, the wording leaves some ambiguity, particularly regarding the consequences of not proactively notifying HMRC.
- If businesses notify HMRC and are confident in their arrangements, it is less likely that HMRC will seek to categorise the structure as "abusive" and take retrospective action.
- However, action based on the legislation quoted by HMRC cannot be retrospective and must be done on a case-by-case basis. HMRC does not need to show the structure is “abusive” or "tax avoidance" but rather that revenue "lost" goes beyond the normal consequence of VAT grouping.

HMRC'S WIDER APPROACH TO TAX AVOIDANCE:

RCB 02/25 reiterates HMRC's broader stance: **"if you're involved in a tax avoidance scheme HMRC will fully investigate your tax affairs and may treat you as a high-risk taxpayer. This means HMRC will closely inspect all of your tax affairs in future, not just your use of the avoidance scheme."**

POTENTIAL CHALLENGES AND LEGAL ARGUMENTS:

The sector is expected to challenge HMRC's position both technically and politically.

Potential arguments include:

> **Legitimate Expectation**: Providers might argue they had a legitimate expectation that the previously unchallenged structures were acceptable for existing contracts.

> **Protection of the Revenue Powers**: HMRC recently lost a First-tier Tribunal case (Barclays) regarding the use of "protection of revenue" powers on VAT grouping, although HMRC has appealed (hearing in March 2026). This case's outcome could be relevant.

CONSEQUENCES FOR LOCAL AUTHORITIES AND ICBS

- Local authorities and ICBs are explicitly included as readers of RCB 02/25.
- We believe local authorities/ICBs are likely to be asked by HMRC which of their providers have used VAT group structures and are charging VAT.
- Local authorities and ICBs will face no tax liabilities or penalties. Unless the provider restructures again, they will continue to receive taxable invoices from the contracted unregulated company, but the provider's VAT efficiency will be lost.

CONCLUSION

HMRC's unexpected and unilateral shift in policy regarding VAT grouping in the care sector has created significant uncertainty and concern. While HMRC intends to apply these changes prospectively by preventing new arrangements and removing entities from existing VAT groups, the long history of these structures and previous HMRC acceptance raise questions about the practical implementation and the potential for challenges.

Care providers using these structures must urgently review their arrangements, seek professional advice, and prepare for potential engagement with HMRC and a likely reduction in VAT recovery benefits.

However, the outcome of possible legal challenges and the Barclays Upper Tribunal appeal in March 2026 will be essential to watch.

For local authorities and ICBs, it is likely very little, if anything, will change in the near future. Providers will continue their VAT group structures until HMRC issues them a Direction. And that will not change the VAT treatment of the provider's supplies to the local authority/ICB – they will continue to be standard rated and the VAT recoverable. Only if the provider reverts to its original structure will its supplies to local authorities and ICBs become VAT-exempt again.

It will take some time for HMRC to cover and dismantle all the care provider VAT group structures.

CONTACT PSTAX

If you have any questions about HMRC’s change in position and its consequences for your organisation, please contact our team.

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