Proceed with care

Andrew Hopkins explains the changes to how HMRC views VAT grouping within the care sector

On 24 April 2025, HMRC published Revenue and Customs Brief 2 (2025), addressing the use of VAT grouping within the care sector.

The Brief sets out HMRC's view that VAT grouping, where a state-regulated (CQC, CI, etc.) care provider forms a VAT group with a non-state-regulated provider of care services, to reduce the cost of irrecoverable VAT, is a form of tax avoidance.

To address these concerns, HMRC sets out a number of immediate actions it will be taking in respect of such structures as follows:

Making use of its revenue protection powers, HMRC will refuse new VAT group applications that are designed to make use of these structures.

In conjunction with the above, HMRC will be launching a programme to review and investigate any such structures where they suspect an 'avoidance scheme' is being used, which could ultimately lead to HMRC removing the non-state-regulated entity from a VAT group, should HMRC determine that tax avoidance is at play.

The matter was again highlighted in HMRC's Spotlight 70, published on 7 May, which provided a brief overview of how the structures typically work or, to use HMRC's words, "are claimed to work". The tone of this publication is stronger than the Brief and makes specific reference to HMRC being aware of "a growing number of state-regulated care providers seeking to gain a tax advantage". It seems clear from the tone of the article that this is not merely a shot across the bows by HMRC and that it will be following through on the proposed action.

So how did we get here?

Welfare services, such as those provided by residential care homes, are exempt from VAT by virtue of Item 9 of Group 7, Schedule 9 of the VAT Act 1994, which provides exemption for:

"The supply by—

(a) a charity,

(b) a state-regulated private welfare institution [or agency], or

(c) a public body,

of welfare services and of goods supplied in connection with those welfare services."

It can be seen that there is effectively a two-part test to be able to apply the exemption. The supply provided must firstly be one of welfare services and secondly must be provided by one of the stated entities. It is the second element of this test that is key to this dispute, namely the status of the entity providing the welfare services and, in particular, the need to be state-regulated.

The structure being challenged by HMRC effectively works as follows:

A VAT Group is formed, consisting of an unregulated entity with a state-regulated care provider, or charity.

Any contracts for the supply of welfare services to customers that can recover VAT (usually local authorities or NHS ICB) are novated to the unregulated entity.

To enable the unregulated entity to make the supplies of welfare services it will usually need to sub-contract the physical provision of the welfare services to the regulated care provider as this is where the care staff/facilities are situated. As there is a VAT group in place, these supplies are disregarded for VAT purposes.

The unregulated provider supplies welfare services to the customer and charges VAT at the standard rate.

Due to the unique VAT status of local authorities and NHS ICBs, the VAT charged is fully recoverable under either Section 33 (Local Authorities) or Section 41 (NHS ICB) of the VAT Act 1994, whereby these entities can recover VAT incurred in relation to their non-business statutory activities.

The VAT group is able to recover VAT incurred on the cost of goods and services that might otherwise have been irrecoverable outside of the VAT group structure.

Action care providers should take

For those organisations that have put this type of VAT grouping structures in place, HMRC's advice is unequivocal. HMRC expect to be notified of the arrangement at the following email address: CAGetHelpOutOfTaxAvoidance@hmrc.gov.uk. Use the subject heading 'VAT grouping'.

While many such arrangements would have been disclosed to HMRC at the time of implementation it is clear that HMRC's stance has changed, and it no longer views these as acceptable. As such, businesses will need to start considering what action is needed and whether such arrangements need to be unwound. Regardless of whether saving or avoiding VAT was a motive in setting up such a structure, we recommend disclosing the use of the structure to HMRC.

It might be preferable to look to do this now in a controlled manner rather than wait to be contacted by HMRC, at which point it might prove more difficult to manage this process in an orderly way.

Local authorities and NHS ICBs, as the customers in these structures, might also take a proactive role in pushing for changes to be made sooner rather than later.

Contracts may need to be novated to the regulated care provider, which will be no small task and until this is undertaken businesses will need to continue applying the same VAT treatment as they are today.

Businesses may also need to consider the financial impact of this change which will significantly increase costs in a sector that is already struggling. This impact could be exacerbated if items which are subject to the VAT Capital Goods Scheme are owned, as there might be a requirement to pay back VAT that was previously recovered on such items in the past 10 years.

Those businesses that have approved Partial Exemption Special Methods (PESMs) will also need to assess whether these need to be amended to take account of the change and also whether those methods need to be revised, if they no longer reflect the consumption of VAT bearing costs within the business in a fair and reasonable manner.

As a final observation, it is not known at this stage how aggressive HMRC intend to be in seeking to revisit historic periods. Spotlight 70 states (when referring to HMRC's powers to remove companies from existing VAT groups) that "any termination notice issued under these powers will only take effect prospectively once the investigation is complete". However, it is difficult to envisage HMRC not looking back retrospectively if there is considered to be sufficient evidence of potential avoidance.

For those businesses that implemented VAT grouping structures with full disclosure to HMRC it will obviously be more difficult for HMRC to revisit the past as long as they have acted in accordance with the stated intention and nothing comes to light during any HMRC investigation to suggest that the structure was entered into with a tax avoidance motive in mind. For those businesses that did not disclose the arrangement, implemented it incorrectly or find themselves subject to accusations of having a tax avoidance motive from the outset, the risk is clearly much higher.

For all businesses that have put these structures in place, regardless of motive, our recommendation is that they should take professional advice to try to manage the situation as successfully as possible.

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