

An Introduction to VAT including Contracted out Services (COS) Direction and PAYE

Like any other business Government Departments are required to comply with HMRC tax legislation. The main areas are:

- Value Added Tax (VAT)
- Income Tax and National Insurance Contributions (NICs)

VAT

Tax is charged on most supplies of goods and services made 'in the course of business'. In general, VAT registered businesses reclaim the VAT they pay on their inputs and charge VAT on their outputs, paying the difference over to HMRC. Further information can be found in the VAT – An Overview factsheet below.

However, Government Departments have special rules for recovering VAT on statutory activities which would not normally be recoverable under 'business rules'. The list of eligible supplies is published by Treasury and is called the Contracted Out Services (COS) Directions. Further summary details can be found in the How VAT Works in Government Departments' factsheet below.

Income Tax and NICs

We all know that our salaries have Income Tax and NICs deducted under the Pay As You Earn System (PAYE). It might not be quite so obvious that there are other things that may create a further tax and/or NICs liability which may be payable through the payroll, or directly to HMRC. For further information see the Income Tax and NICs factsheet below.

Value Added Tax (VAT) – An Overview

VAT is a tax charged on most supplies of goods and services which are ‘made in the course of business’. In general, VAT registered businesses reclaim the VAT they pay on their purchases of goods and services (their inputs) and charge VAT on their sales (their outputs), paying the difference over to HMRC.

The **end-consumer**, who cannot recover VAT, will bear the full VAT charge although the tax itself will have been collected at each successive stage. The end consumer can be an individual, a company or a government department.

Businesses which are **not registered** for VAT can neither reclaim the VAT they pay on their inputs nor charge VAT on their outputs.

In general government departments are out of the scope of VAT because they operate under ‘statute’ rather than ‘in the course of business’. This means that departments are not able to use the business rules to recover the VAT they pay on their inputs.

The inability to reclaim VAT is a major financial issue if a department relies heavily on contracted out services. The Treasury recognised the difficulties and introduced special statutory rules for all government departments allowing them to claim refunds on certain types of service. Government departments rely on these rules to obtain a refund of VAT amounting to £100ms each year.

These rules are described in the Factsheet “Value Added Tax (VAT) – How VAT works in a Government Department”.

Key Facts

- There are three rates of VAT: 20% - **standard rate**, 5% - **reduced rate** and 0% - **zero rate**.
- The rate applicable depends on what exactly is being supplied; for example:
 - most goods and services are charged at 20%
 - Domestic fuel is 5%.
 - Staple foodstuffs are usually 0% while non-staple foodstuffs are 20%. This is why you hear about arguments over whether a Jaffa cake is a cake (0%) or a biscuit (20%) and why, when VAT was applied to hot take-away food, the press coined the phrase ‘pasty tax’.
- Some goods or services are **exempt** from VAT, e.g. dental and optical treatment, and certain financial services.
- **Zero Rated Supplies** are not the same as **Exempt Supplies**.
 - Businesses providing a zero rated supply are still charging VAT but at the rate of 0%. They can recover input VAT as normal.
 - Businesses providing an exempt supply cannot charge VAT on their outputs and they cannot reclaim the VAT paid on their inputs.
- It is the supplier’s responsibility to determine the VAT treatment and the rate to charge, although the purchaser can challenge this decision if he thinks it is wrong.
- If things go wrong HMRC, which administers VAT and publishes a great deal of material to help businesses get things right, has the right to recover the VAT arrears (extrapolated if it’s a systemic problem), plus interest and penalties.

Contact details

Your first point of contact for any questions should be your Finance Business Partner

The Finance Business Partner can seek help from your VAT Liaison Officer who can liaise with the Tax CoE / HMRC.

For more Information:

Value Added Tax (VAT) How VAT works in a Government Department Factsheet (see below)

[HMRC Website](#)

Tax

Value Added Tax (VAT) – How VAT works in a Government Department

VAT is a tax on supplies 'made in the course of business'. Most government departments' (GDs) activities are not 'business', they are provided under statute and are "out of the scope" of VAT. This means they cannot, ordinarily, use the normal business VAT rules to reclaim input VAT. That makes the external costs more expensive to GDs than for normal businesses.

When considering whether to keep services **in-house** or to **contract out**, external bidders' prices appear more expensive because they include VAT. A **special statutory scheme** was introduced to allow departments to obtain a refund of input VAT on certain types of service, enabling them to make a true assessment of the most efficient service delivery option.

Treasury publishes a list of services on which VAT can be refunded called the **Treasury Contracted-Out Services (COS) Directions**. For any service included in the COS Directions, GDs can apply to HMRC for a refund of the VAT it pays on that service.

GDs recover £100ms each year under the COS Directions.

The COS Directions, in the main, apply only to services, not to goods.

It is important to understand that while GDs are usually primarily operating under statute, if it does provide services to other bodies, including other GDs, which those bodies pay for, then they **are acting** 'in the course of business'; it must charge VAT on the service and it must use the normal business rules to reclaim the VAT on those inputs it used in supplying those services.

This is a complex area! Seek help if you need it.

Key Facts

- There are over 75 items listed on the COS Directions. They apply to all GDs, Executive Agencies and Crown NDPBs but not currently other NDPBs or Public Corporations.
- A refund is appropriate only if the service being purchased clearly fits within the definition of that COS Direction.
- Your department's accounting and purchasing systems are likely to be mapped to VAT recovery under the COS Directions. Ensure that you choose the correct purchasing category and account code and follow the procedures properly.
- If VAT is not refunded, the gross cost is applied against your cost centre, if it is refunded the net cost is charged.
- If you are raising invoices for services your GD provides to outside bodies it is likely VAT must be charged. Make sure you use the correct paperwork to raise invoices.
- If things go wrong HMRC has the right to recover the VAT arrears (extrapolated if it's a systemic problem), plus interest and penalties.

It is essential that you contact your Finance Business Partner / GDs Vat Liaison Officer if:

- you are unsure whether a service is VAT recoverable under the Directions
- you / your business is going to start supplying a service to an outside body
- if you don't know if an invoice you are raising should have VAT included
- if you find a error in the way VAT has been treated

Contact details

Your first point of contact for any questions should be your Finance Business Partner.

The Finance Business Partner can seek help from your VAT Liaison Officer who can liaise with the Tax CoE / HMRC.

For more Information:

See the Factsheet - Value Added Tax (VAT) - An Overview (see above)

[HMRC Website](#)

Tax

Income Tax and National Insurance Contributions

We all know that our salaries have Income Tax and National Insurance Contributions (NICs) deducted – this is under the PAYE system. It might not be quite so obvious that there are other things which may create a further tax and NIC liability on your Government Department (GD) and on you!

In simple terms, any payment or any benefit-in-kind you receive 'by way of employment' is potentially subject to tax/NICs from both you and your employer.

This obviously includes your salary, but it can also include things like travel expenses, train tickets, hotel bookings, using hire cars, advances of salary – e.g. for a season ticket, personal car schemes, and so on.

In practice, tax does not have to be paid on many of these because HMRC has allowed GDs a number of exemptions or dispensations. These are allowed on the condition that the GD and employees comply with all the rules and procedures when making/receiving payments and giving benefits-in-kind.

The key here is that both you and your GD must follow your GD procedures and HMRC requirements correctly. If not, HMRC can require payment of tax and NICs.

If you / your GD get it wrong, HMRC has the right to seek payment of all arrears, plus interest and penalties and, if they choose to, they can extrapolate the error calculation. Payment of significant sums, running into many £millions, may result from fairly simple errors.

Your GD's published policies and its payment processes, if followed correctly, are designed to ensure that the tax and NICs are paid in accordance with HMRC rules.

Key Facts

- HMRC rules are complex, sometimes confusing, and at times may seem illogical but GDs, like any employer, must ensure its processes and procedures properly reflect HMRC's rules.
- Your GD's policies should include references to tax liabilities. Staff must follow all policies carefully to guard against non-compliance.
- Payments and benefits-in-kind may be:
 - exempt from tax (e.g. for some GDs where working lunches are provided on their premises)
 - taxable, but the employee can seek a refund of the tax paid, i.e. it is tax deductible; (e.g. most travelling expenses). In these cases your GD and HMRC may have agreed a formal dispensation to allow your GD to pay the expenses net of tax.
 - taxable but your GD may gross up the value and pays the tax directly to HMRC (e.g. the Voucher Reward Scheme)
 - taxable and the employee has to meet the liability (e.g. claiming travel expenses for home to office or office to home journeys or similar journeys to these
- If you receive benefits-in-kind (e.g. personal car schemes, an advance of salary – which is an interest free loan), your GD will provide you and HMRC with a P11D listing the benefits received in the tax year and their values. HMRC will adjust your tax code in the following tax year to recover the tax due on these benefits.
- If you have any questions or concerns, talk to your finance business partner before proceeding.

Some examples of tax treatments and how to claim them compliantly

- **Normal Commute** - Journeys from and to home to your usual workplace are not business journeys for tax purposes. If expenses are paid (eg for weekend attendance) they will be subject to tax/NICs.
- **Substantially Normal Commute** - If you travel from and to home to a temporary workplace which is close to your normal workplace (usually within 10 miles) that journey is treated for tax purposes as if it is the normal commute and any expenses/benefits provided are taxable.
- **Occasional Detached Duty** - If you travel to a temporary workplace which is more than 10 miles from your usual workplace, any expenses claimed are tax deductible, meaning that you can subsequently claim a refund of any tax you have paid. This would obviously be an administrative burden on you, your GD and HMRC so HMRC can give your GD a dispensation to pay these net of tax. You should ensure you claim you expenses on the correct templates.
- **Long-term Detached Duty** - If you attend a temporary workplace for a period of 24 months or more, HMRC rules say that is not temporary for tax purposes. This applies as soon as it becomes known that you will be away for 24 months or more, not when 24 months has passed. The journeys then become the normal commute and the value of any expenses provided, including mileage allowances, hire cars, hotels, train tickets, etc are taxable.
- **Dual-based Worker** - If you are dual based, (eg, you live in York and work in Leeds on Monday and Tuesday, and in London on Wednesday, Thursday and Friday), only travel costs between the workplaces are tax deductible; any journey to/from home and one of the workplaces is your normal commute and expenses paid for it are taxable.

Contact details

If you have any questions, you should speak to your line manager.

Further support can be given by your finance business partner who can seek further guidance from you Tax Team who in turn can liaise with the Tax CoE or HMRC.

See also:

[HMRC Website](#)

[Expenses and benefits: A to Z](#)