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VAT REVERSE CHARGE FOR CONSTRUCTION SERVICES

The VAT domestic reverse charge for building and construction services is now scheduled to come into effect from 1 March 2021. The original introduction date was changed from 1 October 2019 to 1 October 2020 and revised again in June 2020 due to the impact of the coronavirus (COVID-19). The legislation has not changed since it was enacted in 2019 except for a useful alteration to the requirements placed on 'end users' and 'intermediary suppliers'.

The reverse charge represents part of a government clamp-down on VAT fraud. A domestic reverse charge means that a contractor receiving a supply of specified construction services must account for the output VAT due, rather than the subcontractor who supplied the services. The contractor also deducts the VAT due on the supply as input VAT, subject to normal VAT rules, meaning no net tax is usually payable to HMRC. The reverse charge thus removes the scope to evade any VAT owing to HMRC by the subcontractor.

The charge affects only supplies at standard or reduced rates where payments are required to be reported via the Construction Industry Scheme (CIS). It does not apply:

- to zero-rated supplies
- to services supplied to consumers, 'end users' or 'intermediary suppliers' who have given written confirmation of their status to their supplier in respect of the services supplied
- to an employment business supplying either staff or workers.

How will the scheme work?

A VAT-registered business supplying 'specified services' to a VAT and CIS registered business other than an end user or intermediary supplier:

- issues a VAT invoice indicating the supplies are subject to the reverse charge and that the customer must account for the VAT. The invoice does not therefore charge any amount for VAT. It should, however, state how much VAT is due, or the rate of VAT, if the VAT amount cannot be shown.

The business receiving the supply of specified services:

- does not pay output VAT to its supplier on supplies received from them
- accounts for the output VAT on supplies received through its VAT return
- reclaims the VAT on supplies received as input tax, subject to normal VAT rules.

Example

Safe as Houses Ltd is a VAT and CIS registered contractor. It uses Brickyard Bill, who is also VAT and CIS registered. Brickyard Bill issues an invoice which shows the usual information required to be shown on a VAT invoice but instead of charging VAT, the invoice states that the VAT reverse charge applies.

Safe as Houses does not pay VAT to Brickyard Bill. It accounts for the VAT on its own VAT return, entering it as both output and input tax. It enters the value of the purchase from Brickyard Bill as part of its inputs. It does not include the value in its outputs.

Their VAT returns will look like this:

- Brickyard Bill puts the net value of the sales in box six of the VAT return, but no output tax in box one
- Safe as Houses uses box one to declare the output tax on the services from Brickyard Bill to which the charge applies. It doesn't include the value of the transaction as an output in box six. It reclaims the input tax on reverse charge purchases in box four and includes the net value of purchases in box seven.

Specified services

Generally construction services covered by the reverse charge are those falling within the category of 'construction operations' for the CIS. There are two particular points to note.

- The reverse charge includes goods, where supplied with specified services. This is different from the CIS, where CIS payments to subcontractors who are subject to income tax deductions are apportioned to exclude the materials content.
- Services excluded from the definition of construction operations for the CIS are similarly excluded from the VAT reverse charge where these are supplied on their own. But where such services are supplied with services subject to the reverse charge, the whole supply is subject to the reverse charge, as is the case for the CIS.

HMRC guidance provides a '5% disregard' if the reverse charge part of the supply is 5% or less of the value of the whole supply. For example a joiner constructing a staircase offsite then installing it onsite will be making a reverse charge service unless the charge for installation is 5% or less of the overall charge.

Also, if there has already been a reverse charge supply on a construction site, any subsequent supplies on that site between the same parties may be treated as reverse charge supplies, if both parties agree. Where there is any doubt, HMRC's guidance states the reverse charge should apply if the recipient is VAT-registered and payments are subject to the CIS.

End users and intermediary suppliers

The domestic reverse charge applies to VAT-registered businesses throughout the CIS supply chain, but is designed not to apply to 'end users' or 'intermediary suppliers'. End users are VAT and CIS registered businesses receiving supplies of specified services which are not sold on as construction services.

An example of an end user would be a construction firm building an office on land which it owns and selling that interest in land as a newly-built office. Supplies made to the construction firm by subcontractors will therefore be subject to normal VAT rules.

However, if the construction firm undertook a 'design and build' contract for an office to be built on land owned by a customer, the firm will be providing a construction supply to the customer (and will apply normal VAT rules). Construction services supplied by subcontractors to the construction firm will be subject to the reverse charge.

Intermediary suppliers are VAT-registered businesses in receipt of CIS supplies who are connected or linked to end users. Examples could be landlords and tenants, or recharges of building and construction services within a group of companies.

How to determine if supplies are being made to end users or intermediary suppliers

Businesses need to know when they are dealing with an end user or intermediary supplier, so that they can invoice appropriately. Due to the difficulties that may have arisen to suppliers, an amendment has been applied to the legislation requiring end users and intermediary suppliers to notify their suppliers of their status in respect of a particular construction service contract.

If no confirmation is given, the supplier should issue a reverse charge invoice.

The confirmation needs to be 'in writing' or in a written agreement (for example, a contract). HMRC interprets the notification requirements as being satisfied if made on paper and sent by post or electronically in an email.

If you are a supplier of construction services and have any doubt on the correct VAT treatment, you should always ask the customer if they are registered for VAT and the CIS and whether or not they are an end user.

If you often deal with end users or intermediary suppliers, you can include a statement in your terms and conditions to say you assume that your customer is an end user or intermediary supplier unless they say they are not. This places responsibility on the customer to respond if this is not the case.

HMRC guidance

HMRC has now issued revised guidance. This link sets out what you need to do and has links to further guidance: **https://bit.ly/2T6zKG1**. There is also a technical guide: **https://bit.ly/31bAoXk**. The technical guide has a list of contents covering specific areas which may be relevant to your particular circumstances. At the end of the technical guidance there are two useful flowcharts which summarise the steps that need to be taken to determine whether a supply is subject to the reverse charge.

HMRC will apply a 'light touch' on genuine errors for six months from March 2021, where businesses are aiming to comply and act in good faith.

Planning for the new regime

Key action points:

- establish when the reverse charge is likely to apply to supplies to and from other VAT-registered contractors and subcontractors you deal with. Before you can apply the reverse charge you need to be satisfied that your customer is VAT-registered and your contract is within the CIS
- check that your accounting systems will calculate and report reverse charge supplies. Invoices will need to specify that the reverse charge applies
- establish procedures for additional information you will need from some of your customers
- consider the training staff will require to deal with the new rules
- estimate the cashflow consequences on your business if you no longer hold output tax. It may be that changing to a monthly VAT return cycle to accelerate payments due from HMRC would be of benefit.

If you are a supplier using the Cash Accounting Scheme or the Flat Rate Scheme, neither of these schemes can be used for the supply of services that are subject to the reverse charge. This may mean that it is no longer beneficial to use these schemes.

How we can help

The change means that the construction sector is likely to be subject to considerable HMRC scrutiny in the foreseeable future. The reverse charge may highlight that some construction services may not have been correctly classified in the past. For these reasons, we would recommend taking stock of VAT and CIS compliance across the board.

Please contact us for an in-depth discussion, or for advice on cashflow and financial management strategies to help your business adapt successfully to the new regime.

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