



Construction reverse charge VAT

The reverse charge represents part of a government clamp-down on VAT fraud. Make sure you understand the impacts on your business.

Large amounts of VAT are lost through 'missing trader' fraud

The VAT domestic reverse charge for building and construction services comes into effect from **1 March 2021**. We have pulled together some guidance on when you must use the VAT reverse charge for building and construction services.

Overview

The reverse charge represents part of a government clamp-down on VAT fraud. Large amounts of VAT are lost through 'missing trader' fraud. In this type of fraud, VAT is charged by a supplier, who then disappears, along with the output tax. The VAT is thus lost to HMRC. Construction is considered a particularly high-risk sector because of the potential to make supplies with minimal input tax but considerable output tax.

The reverse charge does not change the VAT liability: it changes the way that VAT is accounted for. In future the recipient of the services, rather than the supplier, will account for VAT on specified building and construction services. This is called a 'reverse charge'.

The reverse charge is a business to business charge, applying to VAT-registered businesses where payments are required to be reported through the Construction Industry Scheme (CIS). It will be used through the CIS supply chain, up to the point where the recipient is no longer a business making supplies of specified construction services. The rules refer to this as the 'end user'.

Broadly then, the reverse charge means that a contractor receiving a supply of specified construction services has to account for the output VAT due - rather than the sub-contractor supplying the services. The contractor then also has to deduct the VAT due on the supply as input VAT, subject to the normal rules. In most cases, no net tax on the transaction will be payable to HMRC.

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

- + to zero-rated supplies
- + to services supplied to end users
- + in some situations where suppliers are connected to end users. This covers landlords and tenants, intra-group and leasing recharges of building and construction services.



Example

Safe as Houses Ltd is a VAT-registered contractor. It uses Brickyard Bill, who is also VAT-registered. Brickyard Bill tells Safe as Houses that 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 value of the sales in box 6 of the VAT return: but no output tax in box 1

Safe as House uses box 1 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 6. It reclaims the input tax on reverse charge purchases in box 4 and includes the value of purchases in box 7.

In outline, the scheme is expected to operate as follows:

A VAT-registered business, receiving a supply of specified services (see below) from another VAT-registered business, for onward sale, on or after **1 March 2021**

- + should account for the output VAT on supplies received through its VAT return
- + does not pay the output VAT to its supplier on supplies received from them
- + can reclaim the VAT on supplies received as input tax, subject to normal VAT rules.

The supplier should:

- + issue a VAT invoice indicating the supplies are subject to the reverse charge.

An end user should:

- + notify its end user status, so the supplier can charge VAT in the usual way.

The reverse charge includes goods, where supplied with specified services.

Details of the charge have changed since first announced. The charge was originally to apply to 'labour only' supplies. Now, however, the charge applies to construction services including materials. This gives the legislation wider application than first suggested.

Impact on business

With the domestic reverse charge, the value of reverse charge supplies will not count towards the VAT registration threshold of the recipient business.

For many construction businesses, the change is likely to have far-reaching consequences. Processes will need to be in place to ensure VAT accounting systems are compliant with the unusual requirements of the reverse charge. And given that output VAT currently provides many businesses in the supply chain with a positive cash flow advantage, the impact on cash flow and liquidity will also need appraisal.

Businesses using the VAT flat rate scheme (FRS) may find that the new rules work against them. We should be pleased to review your individual circumstances to establish whether the FRS will still be of benefit to you, or whether withdrawal from the scheme would be more advantageous.

Specified services

Construction services covered by the reverse charge are those falling within the category of 'construction operations' for CIS, and include the construction, alteration, repair, extension, demolition or dismantling of buildings or structures, including offshore installations.

Works forming part of the land, such as walls; roads; runways; railways; pipe and power-lines are also included. So, too, are the installation of systems of heating, and lighting; painting and decorating; and

preparatory services such as site clearance and the erection of scaffolding.

Supplies excluded from the charge - where these are supplied on their own - include the services of architects, surveyors and some consultants; and the manufacture of building or engineering components, materials or plant. However, the mixed supplies rule comes into play where any of these are supplied with supplies subject to the reverse charge. This means that if there is a supply containing a reverse charge element, the whole supply is subject to the reverse charge, even if these elements are invoiced separately. There is no need to apportion or split out the reverse charge supply. This is subject to a '5% disregard', so if the value of services that are subject to the reverse charge make up 5% or less of the total value of the whole supply this can be disregarded.

The reverse charge includes goods, where supplied with specified services, again even if these are invoiced separately, but subject to the 5% disregard mentioned above.

Other issues

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 recommends reverse charging, if the recipient is VAT-registered and payments are subject to CIS.

“ 'End users' are VAT-registered businesses receiving supplies of specified services which are not sold on as construction services.

End users

Domestic reverse charge applies to VAT-registered businesses throughout the CIS supply chain, but is designed not to apply to 'end users'. 'End users' are VAT-registered businesses receiving supplies of specified services which are not sold on as construction services. Examples could be a construction firm selling an interest in land as a newly-built office, or a large retail business having trading premises built for its own use.

End users should notify suppliers of their end user status in respect of the services, and instruct them to charge VAT in the normal way, rather than reverse charging. Suppliers will not necessarily be aware of this themselves. However, if the end user does not give confirmation of end user status, the supplier should issue a reverse charge invoice, and the end user will be responsible for accounting for the reverse charge. Notification of status should be in writing and retained for future reference.

Invoices

To invoice correctly under the new rules, suppliers should mark the invoice to the effect that domestic reverse charge applies, and that the customer must account for VAT. This requirement is in addition to the usual level of information required on a VAT invoice. The amount of VAT due under the charge should be clearly stated on the invoice. It should not be included in the amount shown as total VAT charged.

The rules require that when the customer is liable for VAT, an invoice should include the reference 'reverse charge'. Any of these wordings is acceptable:

- + Reverse charge: VAT Act 1994 Section 55A applies
- + Reverse charge: S55A VATA 94 applies
- + Reverse charge: Customer to pay the VAT to HMRC.

Where invoices are created with an IT system that cannot show the amount to be accounted for, HMRC refers suppliers to VAT Notice 735 Domestic reverse charge procedure [bit.ly/2OsGJWK](https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services).

HMRC policy

The government has published a final version of the draft Statutory Instrument providing for the reverse charge, and HMRC has issued some technical guidance <https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services>

Businesses knowingly claiming end user status when the reverse charge should have applied will be liable for output tax due, and may be liable for penalties.

Will your cash flow suffer if you no longer hold output tax?

The new rules will have a significant effect on VAT compliance and cash flow. We therefore recommend planning to accommodate this well before the March deadline.

Planning for change

Key areas to consider now include:

- Is the reverse charge likely to apply to supplies to and from other VAT-registered contractors and sub-contractors you deal with?
- How will your accounting systems calculate and report reverse charge supplies?
- How will you check on an ongoing basis that supplies and purchases are treated correctly?
- Will your cash flow suffer if you no longer hold output tax, and what can be done to compensate for this?
- What training will staff require to deal with the new rules?
- Is there additional information you will need from your customers and how will you obtain this?
- If you use the VAT Flat Rate Scheme, how will the charge impact you?

Overall, the change means that the construction sector is likely to be subject to considerable HMRC scrutiny in the foreseeable future. Under the new rules, for example, some sub-contractors, with VAT to reclaim on inputs, but no VAT to charge on outputs, will regularly receive VAT refunds.

A regular repayment position could trigger a VAT inspection. For these reasons, we would recommend taking stock of VAT and CIS compliance across the board.





How can we help?

In this briefing we have only been able to touch on some of the issues involved, and some details may yet change as the rules are finalised.

Please do contact us for an in-depth discussion, or for advice on cash flow and financial management strategies to help your business adapt successfully.

What you need to do

1. Check when you must use the reverse charge on your sales, purchases or both
2. Find out how the charge works if you supply services
3. Find out how the charge works if you buy services
4. Read more detailed guidance about the reverse charge
5. Contact us to get help and support for VAT

“ With careful planning and advice, we will guide you through the maze of regulations imposed on the industry to help minimise compliance costs and build a successful future.

For information of users

This material is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material can be accepted by the authors or the firm.

Date of publication : January 2021



forrester-boyd.co.uk
info@forrester-boyd.co.uk

Grimsby

Tel: 01472 350601

26 South St. Mary's
Gate

Grimsby

N E Lincolnshire

DN31 1LW

Louth

Tel: 01507 606111

Waynflete House

139 Eastgate

Louth

LN11 9QQ

Scunthorpe

Tel: 01724 863105

66/68 Oswald Road

Scunthorpe

North Lincolnshire

DN15 7PG

Skegness

Tel: 01754 761777

47 Alghitha Road

Skegness

Lincolnshire

PE25 2AJ

Beverley

Tel: 01482 889400

Kingfisher Court

Plaxton Bridge Road

Woodmansey

Beverley

HU17 0RT

Hull

Tel: 01482 225564

The Counting House

Nelson Street

Hull

East Yorkshire

HU1 1XE

Forrester Boyd Chartered Accountants is a trading style of Forrester Boyd, a partnership operated from Grimsby, Louth, Scunthorpe and Skegness.

Forrester Boyd Chartered Accountants is a trading style of Forrester Boyd Robson Limited operating from Beverley and Hull. Forrester Boyd Robson Limited is a company incorporated in England and Wales with company number 08370127 and registered office at Kingfisher Court, Plaxton Bridge Road, Woodmansey, Beverley, HU17 0RT and a wholly owned subsidiary of Forrester Boyd.

Forrester Boyd Wealth Management is a trading style of FB Wealth Management Limited, which is authorised and regulated by the Financial Conduct Authority. The Financial Conduct Authority does not regulate advice on trusts, taxation or Will writing services.

