

VAT Reverse Charge for Construction Services

What changes are being introduced?

On 1 October 2019, HM Revenue and Customs' (HMRC) new domestic reverse charge for construction services will come into force. In future, the legislation requires the recipient rather than the supplier to account for the VAT due on certain construction services. The new legislation is aimed at combating fraud in the construction sector. It will be introduced without a transitional period and will have a significant impact on businesses in this sector.

Under the new rules, a VAT registered business, which supplies certain construction services to another VAT registered business for onward sale, will have to issue a VAT invoice stating that the service is subject to the domestic reverse charge. The recipient must account for the VAT due on that supply through its VAT return, by including it in box 1 (rather than paying the VAT amount to the supplier). The recipient can then recover the VAT amount by including the amount as input tax in box 4, resulting in a 'cash neutral' transaction in terms of cashflow.

Which construction services will the new rules apply to?

The new domestic reverse charge will apply to supplies of 'specified services' between VAT registered businesses where the recipient will then make an onward supply. Specified services are generally services that are defined as "Construction Operations" for purposes of the Construction Industry Scheme (CIS), among those included are:

- Construction;
- Alteration;
- Repair;
- Extension;
- Demolition;
- Painting and Decorating;
- Civil Engineering; and
- Installation of Heating, Lighting and Air-Conditioning.

The legislation is written so that if there is a reverse charge element in a supply then the whole supply will be subject to the domestic reverse charge.

Where specified services have been provided, subsequent services on the same site made by the same supplier, may also be covered by the domestic reverse charge, provided both parties agree. However, where the original services did not come within the scope of the domestic reverse charge, but subsequent services do, then the VAT treatment will change. Businesses will therefore need to monitor the VAT position throughout the term of each contract.

Services fall within the domestic reverse charge when:

- The services are standard-rated or at the reduced rate;
- The customer is a contractor (i.e. is selling on the services they have received);
- The customer is VAT-registered;
- The transaction falls in whole or in part under the CIS (meaning that both labour and materials are reverse-charged even where only labour is accounted for through CIS); and
- The customer is not an 'End User' (defined below).

Who is an End User?

An End User is a person who receives the specified services for any purpose other than making an onward supply of those services. The customer must state if it is an End User. Where the customer has not provided this confirmation, either in writing, an email, or in the contract, HMRC's guidance is that the supply will come within the scope of the domestic reverse charge and no VAT is charged. On occasions, it may be clear to the contractor that its customer is an End User and should be charged VAT, even though the customer has not given confirmation. In these situations, HMRC's latest guidance says that it will be acceptable to charge VAT in the normal way. In addition to confirming if your customer is an End User, you should also ask them to confirm their VAT and CIS status and provide their VAT registration number. We recommend that this is confirmed in the contract before any invoices are raised.

What about building materials?

Where building materials are provided together with construction services in the course of the construction work, then the reverse charge also applies to these goods. There are likely to be cases where it is difficult to determine if there is a separate supply of goods that is excluded from the reverse charge, or whether they are to be included as part of a single supply of construction services. In these cases, businesses will need to consider the position further to ensure the correct VAT treatment.

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What is required on invoices for supply of these services?

Invoices for services subject to the domestic reverse charge must include all of the normal information previously required. However, they must make it clear that the domestic reverse charge applies and that the customer (or recipient) is required to account for the VAT. HMRC suggest the following wording:

- "Reverse charge: VAT Act 1994 Section 55A applies"; or
- "Reverse charge: S55 VATA 94 applies"; or
- "Reverse charge: Customer to pay VAT to HMRC".

If a customer issues an authenticated tax receipt or self-billing invoices, HMRC's suggested wording is:

- "Reverse charge: we will account for and pay the output tax due to HMRC"; or
- "Reverse charge: as the UK Customer we will pay the VAT due to HMRC".

What will be the likely impact on construction businesses?

Construction businesses will need to ensure their accounting systems are capable of processing reverse charge supplies and make ongoing checks to ensure that supplies and purchases are correctly treated. As the VAT amount must still be shown on invoices subject to the domestic reverse charge, there is a risk that suppliers will account for the VAT to HMRC in error and customers will recover it from HMRC – so care must be taken!

It is vital that businesses currently using the Flat Rate Scheme (FRS) leave the scheme before the new rules come into effect. The FRS would leave the same percentage of income due as VAT payable to HMRC even if the VAT element is being handled by the customer under the reverse charge.

Subcontractors who rely on Output VAT collected from their customers as working capital until they have to pay it over to HMRC are likely to suffer from the loss of cash flow. Often, businesses (especially those early in the supply chain) are operating on low margins and rely on the VAT collected to bolster short-term cash flow. These businesses will need to consider if payment terms need to be revised in order to mitigate the cashflow impact.

Subcontractors will also need to confirm that they are working for a VAT registered business and whether they are working for an end End User, or for someone connected to an End User, including landlords and tenants.

What action do construction businesses need to take now?

Construction businesses need to:

- Review supplies made to, and received from, other VAT registered contractors to establish where they will be caught by the new rules;
- End Users on the receiving end of construction work need to confirm their status to contractors. It would be good practice for sub-contractors to obtain confirmation from the last customer in the chain that they are an End User and get confirmation of their VAT registration number and CIS status;
- Consider any adaptations required to accounting systems;
- Consider the impact on cash flow from October 2019 and ways to mitigate this. Don't forget that if in future these changes put you in to a VAT refund position, where previously you have always made a payment of VAT to HMRC, they may query the refund due back to you! Also, if under the new regime you are likely to receive VAT refunds, it will almost certainly be beneficial from a cash flow perspective to opt for monthly VAT returns to be made as opposed to quarterly; and
- If you use the FRS, you should almost certainly leave the scheme before October 2019.

For more information on these changes you can refer to HMRC's detailed guidance (www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services) or contact your local Whitley Stimpson office for guidance.

NB This document is designed for general guidance only and no responsibility can be taken by the writer for any action taken or not taken on the basis of the contents.