

THE CONSTRUCTION INDUSTRY AND VAT: ANALYSING THE CHANGES



The VAT domestic reverse charge for building and construction services comes into effect from 1 October 2020. Given the scale of the changes, it would be appropriate for those businesses to plan for the reverse charge now.

THE REVERSE CHARGE: AN OVERVIEW

The reverse charge represents part of a government clampdown on VAT fraud. Large amounts of VAT are lost through 'missing trader' fraud. As part of 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 subcontractor 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 and not to:

- zero-rated supplies;
- services supplied to 'end users' or 'intermediary suppliers'.

Under the scheme a VAT-registered business, receiving a supply of specified services from another VAT-registered business, for onward sale, on or after 1 October 2020:

- 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.

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 the 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 Houses 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.

CONSEQUENCES FOR BUSINESSES

Details of the charge have changed since it was first announced. Originally, the charge was to apply to 'labour-only' supplies. Now however, the charge applies to construction services, including materials. 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. The rules require a number of verification checks to ascertain VAT status of customers, CIS registration (in some circumstances) and end user or intermediary supplier status. Given that output VAT currently provides many businesses with a positive cashflow advantage, the impact on cashflow and liquidity will also need appraisal. Changing the monthly VAT return cycle to accelerate payments may be of benefit. The VAT Flat Rate Scheme may be of benefit, and reverse charge transactions through the Cash Accounting Scheme.

SPECIFIED SERVICES

Construction services within the category include the construction or dismantling of installations.

as walls; pipework as site clearance of heating

charge in their own consulta compone

SERVICES EXCLUDED

Where excluded reverse charge. As it can be a reverse charge supply on a contract between the same if both parties agree reverse charging, if the subject to the CIS.

CONSIDERING END USERS

The domestic reverse charge applies to VAT throughout the CIS supply chain, but is designed for 'end users' or 'intermediary suppliers'. '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. Intermediary suppliers are VAT and CIS registered businesses that 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.

Businesses will need to know when they are dealing with an end user or intermediary supplier, so they can invoice appropriately. The end user or intermediary supplier should inform the supplier of their status so that VAT can be charged as normal. If the end user does not provide confirmation of status, the supplier should issue a reverse charge invoice. Businesses dealing frequently with end users may wish to include a statement, in business terms and conditions, to the effect that it is assumed that the customer is an end user, unless they indicate otherwise.

EFFECTIVE INVOICING

To invoice correctly under the new rules, suppliers should mark the invoice to the effect that the domestic reverse charge applies, and that the customer must account for VAT. The amount of VAT due under the charge should be clearly stated on the invoice. It should be included in the amount shown as total VAT charged.

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How we can help

In this factsheet we have only been able to touch on some of the key issues. Please contact us for an in-depth discussion on the matter.