

VAT:
Domestic reverse charge for building
and construction services



What is the reverse charge?

The domestic reverse charge, commonly referred to as the reverse charge, is a major change to the way VAT is collected in the building and construction industry and will affect both suppliers and customers that are both VAT and CIS registered.

The changes come into effect on 1 March 2021 and means the supplier will no longer charge VAT on its specified supplies. The customer receiving the supplies will be responsible for accounting for and paying any VAT due to HMRC.

Services affected by the changes

Specified supplies

The reverse charge will affect supplies of building and construction services supplied at the standard or reduced rates of VAT that also need to be reported under CIS. HMRC define these supplies as 'specified supplies'.

There is an important difference between CIS and the reverse charge where materials are included within a service. The reverse charge will apply to the whole service whereas CIS payments to net status sub-contractors are apportioned and no deductions are made on the materials content.

If any of the services in a supply are subject to the reverse charge, all other services (even if that service would be excluded if it were being supplied as a single service) will also be subject to it.

If there is any doubt whether a type of works falls within the definition of a specified service, as a general rule - as long as the recipient is VAT registered and the payments are subject to CIS, the reverse charge should apply.

HMRC has provided the following are examples of the type of services suppliers should apply the reverse charge to:

- *Constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services*

- *Constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours*
- *Pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence*
- *Installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure*
- *Internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration*
- *Painting or decorating the inside or the external surfaces of any building or structure*
- *Services which form an integral part of, or are part of the preparation or completion of the services described above - including site clearance, earth-moving, excavation, tunnelling and boring, laying of foundations, erection of scaffolding, site restoration, landscaping and the provision of roadways and other access works*

It is important to note that the reverse charge does not apply if the service is zero rated for VAT or if the customer is not registered for VAT in the UK.

The reverse charge will also not apply to services supplied to end users or intermediaries and to some other services listed below.

Examples of services not subject to the reverse charge:

- *Drilling for, or extracting, oil or natural gas*
- *Extracting minerals (using underground or surface working) and tunnelling, boring, or construction of underground works, for this purpose*
- *Manufacturing building or engineering components or equipment, materials, plant or machinery, or delivering any of these to site*
- *Manufacturing components for heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems, or delivering any of these to site*
- *The professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants*
- *Making, installing and repairing art works such as sculptures, murals and other items that are purely artistic*
- *Signwriting and erecting, installing and repairing signboards and advertisements*
- *Installing seating, blinds and shutters*
- *Installing security systems, including burglar alarms, closed circuit television and public address systems*



End users and intermediaries

The reverse charge does not apply to consumers or final customers i.e. those that do not make onward supplies of the building and construction services. These are end users.

Any consumers or final customers who are registered for VAT and CIS, will need to ensure their suppliers do not apply the reverse charge on services supplied to them by notifying the supplier that they are an end user.

An intermediary supplier is a VAT and CIS registered businesses that is connected or linked to end users. An intermediary supplier can also be treated as an end user when it is the final customer. To be connected or linked to an end user, intermediary suppliers must either share an interest in the same land where the construction works are taking place or be part of the same corporate group.

Businesses cannot choose whether they are an end user or an intermediary supplier - it will be a matter of fact.

Suppliers that are not sure whether their customer is an end user or intermediary supplier should ask their customer if they are an end user or intermediary supplier and keep a record of the answer. It will be up to the customer to notify the supplier that they are an end user or intermediary supplier and that VAT should be charged in the normal way instead of being subject to reverse charge.

Examples of end users include UK VAT registered mainstream or deemed contractors under CIS rules. They are typically not construction businesses and are found in the retail, manufacturing, utilities and property investment sectors as well as public bodies. Property developers should also be end users in cases where they do not make onward supplies of building or construction services.

Employment businesses supplying construction workers

Employment businesses supplying construction workers are not likely to be considered to be a building and construction service for VAT purposes.

For VAT purposes such activities of workers are supplies of staff by their employer and not supplies by the workers themselves.

The important distinction between supplying staff and supplying construction services is that the individual workers are employed or paid by the employment business and not by the construction business that uses them to provide construction services.

Checklist

Businesses will need to prepare for this change by:

- *Checking whether the reverse charge affects either their sales, purchases or both*
- *Contacting regular clients or suppliers to let them know*
- *Making sure their accounting systems and software are updated to deal with the reverse charge*
- *Consider whether the change will have an impact on their cash flow*

Contracts

Determining reverse charge treatment of existing contracts to be ready for 1 March 2021

For businesses that have a variety of contracts, it may be difficult to establish whether the reverse charge applies or not in the run-up to 1 March 2021 and afterwards.

HMRC has advised that they will accept circumstances where the same VAT treatment has been applied across all contracts with a particular sub-contractor in the run up to 1 March 2021 that continue beyond that date. For example, if the contractor looks across all construction contracts with a sub-contractor and is satisfied that the reverse charge will apply to more than 5% of contracts (by volume or value) with that sub-contractor, then the reverse charge may be applied to all the contracts.

For contracts starting after 1 March 2021 businesses should use the reverse charge if it applies from the start of the contract.

Change of VAT treatment during a contract

There may be contracts where a change in circumstances mean the reverse charge treatment changes, for example where the customer changes to be the end user or vice versa.

Where a contract changes, the customer should notify the supplier of the change to apply the correct VAT treatment. The new treatment will apply at the point the customer's circumstances change.

Where changes happen during an invoice period, HMRC accept that the supplier can opt to change to the new treatment for the entire invoice period or apply the new treatment to the next invoice period.

Suggested amendments to standard contract wording

Suppliers should consider amending standard wording in their contracts that sets out the VAT treatment of their supplies. Example wording: 'Under the VAT Regulations 1995 Section 55A invoices for services subject to the reverse charge where the customer is liable for the VAT'.

For contracts with end users suggested wording for the contract: 'The customer confirms that it is an end user or connected to an end user for the purpose of VAT Regulations 1995 Section 55A'. This will ensure that the supplier accounts for VAT in the normal way instead and not subject to reverse charge.



Compliance issues

Completing your VAT return

Under the new rules, suppliers will no longer charge VAT on their standard or reduced rated supplies of specified services to their customers where they are not the end user and are both CIS and VAT registered. This means that the way in which VAT is reported on the VAT returns of affected suppliers and customers will change as follows:

- **VAT on sales (suppliers)**

For sales under the reverse charge suppliers must not enter any VAT on sales to which the domestic reverse charge applies in box 1 of the VAT return. The net value of the sale must be entered in box 6 (net sales).

- **VAT on purchases (customers)**

Customers purchasing a service subject to the reverse charge must enter the VAT on purchases the domestic reverse charge applies to in box 1 of the VAT return. Make sure you do not enter the net value of the purchase in box 6.

Customers may reclaim the VAT on the reverse charge purchases in box 4 subject to the normal rules. For customers that are fully taxable, the net VAT in most cases will be nil. The net value of the purchases should be included in box 7 as normal.

Most accounting packages should be able to deal with the reverse charge transactions by posting to a specific tax code.

VAT invoices

It will be essential for customers to be able to identify when the supplier is treating its supplies of goods and services under the new reverse charge. When supplying a service subject to the reverse charge, suppliers should:

- Show all the information required on a VAT invoice, but do not add VAT to the supply
- Make a note on the invoice to make it clear that the reverse charge applies and that the customer is required to account for the VAT. This can simply be a sentence on the description of the goods e.g. 'Domestic reverse charge applies'
- Clearly state how much VAT is due under the reverse charge, or the rate of VAT, if the VAT amount cannot be shown. For businesses that use software to produce invoices and are unable to show the amount of VAT to be accounted for under the reverse charge, the wording should state that VAT is to be accounted for by the customer at the standard or reduced rate of VAT, based on the VAT-exclusive selling price for the reverse charge goods or services.

Self-billing invoices issued by customers should:

- Show the supplier's name, address and VAT registration number (as well as the usual VAT invoice details)
- Clearly mark the self-billed invoice with the reference self-billing
- Clearly state the amount of VAT due under the reverse charge or the rate of VAT if the VAT amount cannot be shown under the reverse charge
- Include wording on the invoice that shows the domestic reverse charge applies, e.g. 'Domestic reverse charge: we will account for and pay the output tax due to HMRC'

Tax point spanning 1 March 2021

The general rule is that a tax point is the date the transaction takes place for VAT purposes. However, suppliers of building and construction services will usually be seen as providing continuous supplies of services for VAT purposes. This normally means VAT is due when a VAT invoice is issued or payment is received - whichever is earlier.

For invoices issued for specified supplies spanning 1 March 2021 that become liable to the reverse charge, the following VAT treatment will apply:

- If the tax point is before 1 March 2021 - the normal VAT rules will apply and VAT should be charged at the appropriate rate
- If the tax point is on or after 1 March 2021 - the domestic reverse charge will apply

VAT schemes

The new changes will have an effect on the way the cash accounting scheme and the flat rate scheme operates.

Cash accounting scheme:

The cash accounting scheme cannot be used for the supply of services that are subject to the reverse charge. This will have an impact on how some businesses manage their accounts.

- **Suppliers**

Under the reverse charge, no VAT is actually paid by customers to suppliers, so there will be no additional adverse cash flow impact for businesses who use cash accounting.

Suppliers can still use the Cash Accounting Scheme for supplies that are not within the reverse charge. However, suppliers will be required to also account for its purchases under the scheme. This may not help with cash flow and so suppliers may opt to leave the scheme.

- **Customers**

Under normal VAT rules, customers that use the Cash Accounting Scheme cannot reclaim VAT charged on supplies until payment has been made to the supplier.

Under the new rules, customers that receive services that fall under the reverse charge will not be charged VAT by the supplier. Instead, the customer will account for the VAT and recover it simultaneously on the same VAT Return at the tax point and subject to the normal rules.

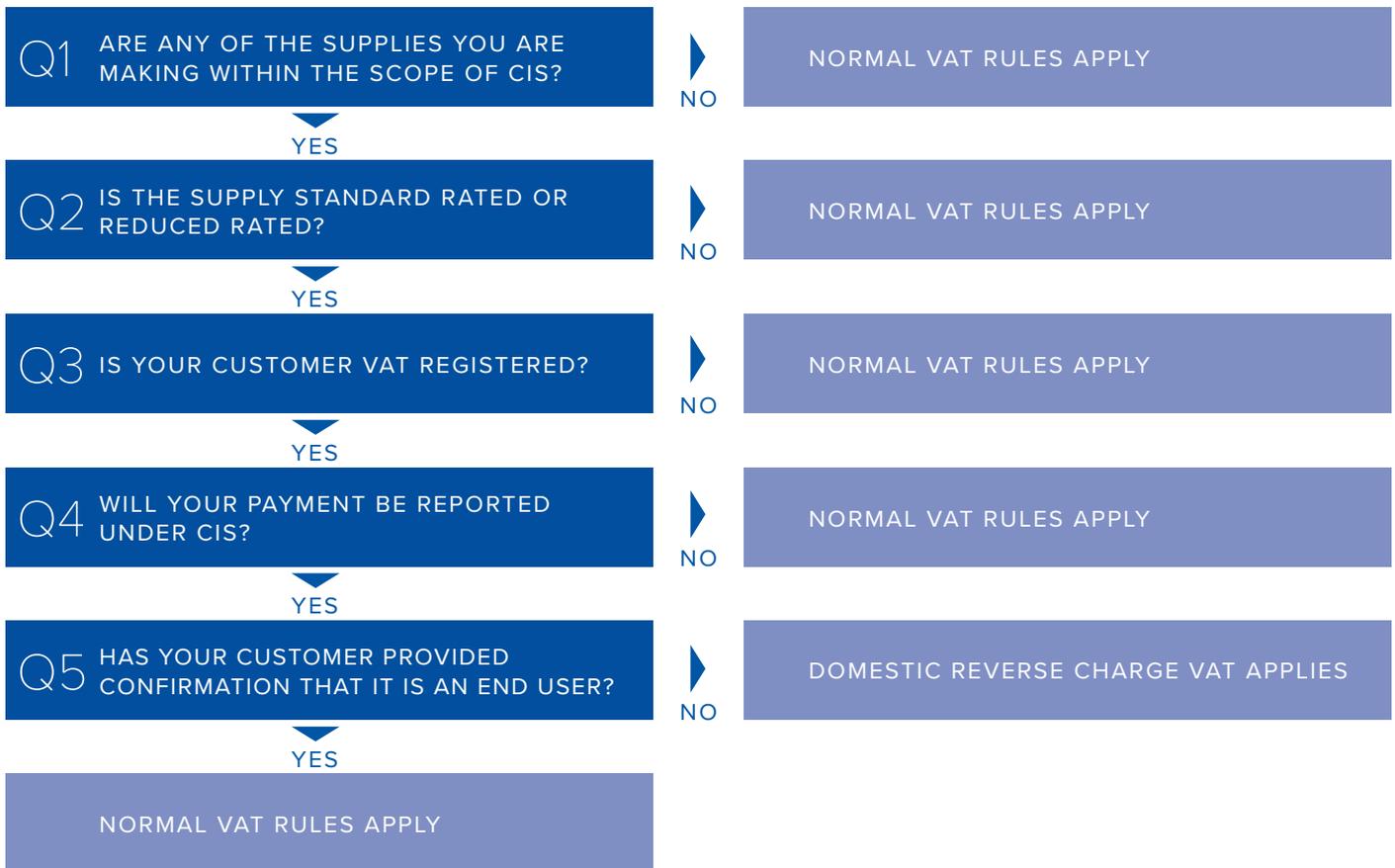
Flat rate scheme:

Reverse charge supplies should not be accounted for under the flat rate scheme. This will mean that users of the scheme will have to consider if it is still beneficial to them when VAT is not being paid to them on some or all of the invoices they issue.

Flat rate scheme users who receive reverse charge supplies will have to account for the VAT due to HMRC.

VAT reverse charge for building and construction services

This flow chart can be used to establish whether to normal vat rules apply or whether the domestic reserve charge should be used.



Contact us

MORE INFORMATION?
PLEASE GET IN TOUCH WITH ONE OF OUR EXPERTS



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