

VAT: DOMESTIC REVERSE CHARGE ON BUILDING & CONSTRUCTION SERVICES

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VAT: DOMESTIC REVERSE CHARGE ON BUILDING & CONSTRUCTION SERVICES

PLEASE NOTE THE REVERSE CHARGE WILL NOW NOT APPLY UNTIL 1 MARCH 2021 – ALL REFERENCES TO 1 OCTOBER 2019 SHOULD BE REPLACED BY 1 OCTOBER 2020

NEW VAT RULES FOR BUILDERS

There will be a major change in the way VAT is collected in the building and construction industry as a result of new procedures being introduced from 1 October 2019. It is called the Domestic Reverse Charge (DRC). 'Domestic' relates to UK rather than International.

This factsheet provides some of the provisions you need to be aware of. However, it is not comprehensive and we recommend that you visit the HMRC website at:

<https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services> for more detailed guidance.

Why introduced?

HMRC has identified that certain builder supplies have been prone to VAT fraud, where the supplier charges VAT to his customer, receives money for this VAT from the customer but never declares it on a VAT return. The new procedures aim to prevent this from happening.

What is the change?

From 1 October 2019, the **customer or beneficiary** receiving the service will have to pay the VAT due to HMRC instead of paying the supplier the VAT, unless the customer or beneficiary is an 'end user or 'intermediary supplier' – see below.

When does the DRC apply?

There are 3 things to consider if a service is to be included in the DRC scheme. These are:

1. The work must be of a kind covered by the DRC scheme.
2. The customer must be registered for both VAT and CIS (Construction Industry Scheme). For CIS, it is immaterial whether gross payment status applies.
3. Whether or not the customer is an 'end user'.

There is a flowchart in the Appendix to help you determine if DRC will apply.

What happens if the DRC applies?

In simple terms, if DRC applies, the supplier of the service does not charge VAT to their business customer. Instead, it will be the business customer who will account for the VAT to HMRC and also claim back the same amount in their VAT return.

Who is an 'end user' for DRC purposes?

An end user could be VAT and CIS registered final contractors or consumers who are not on-charging their service. DRC does not apply to end users.

What is an 'intermediary supplier' for DRC purposes?

Intermediary suppliers are VAT and CIS registered businesses that are **connected or linked** to end users e.g. a company under common control. DRC does not apply to intermediary suppliers who do not make supplies of building and construction services to third parties

and as such are excluded from the scope of the reverse charge if they receive such supplies. Examples also include landlords, tenants and property developers.

What kind of work/services are covered by the DRC scheme?

Generally, it includes most building and construction services supplied at the standard rate of 20%, or reduced rate of 5%, that also need to be reported under CIS including:

‘installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure.’

What kind of work/services are excluded from the DRC scheme?

There are various services that are not subject to the reverse charge, including:

‘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’ i.e. supply of goods only.

‘the professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants’

‘installing security systems, including burglar alarms, closed circuit television and public address systems.’

Repair of building services components.

What you need to do to get ready for the new rule on 1 October 2019

1. check whether the reverse charge affects either your sales, purchases or both.
2. update your accounting systems and software to deal with the reverse charge.
3. consider whether the change will have an impact on your cashflow.
4. make sure staff responsible for VAT are familiar with the operation of the new rules.
5. verify the VAT status of your customers in order to apply the DRC. You can check a customer’s VAT number is valid and belongs to them on the EU website at: http://ec.europa.eu/taxation_customs/vies/
6. Ask new customers to provide details of their registration as a contractor for CIS purposes, but HMRC recommends that you use the HMRC CIS verification system online service at <https://www.gov.uk/use-construction-industry-scheme-online>

What contractors need also to do

If you’re a contractor you’ll need to review all your contracts with sub-contractors to decide if the reverse charge will apply to the services you receive under your contracts. It will be up to a business customer to make a supplier aware that that they are an end user or intermediary supplier and that VAT should or should not be charged.

What sub-contractors also need to do

If you’re a sub-contractor you’ll also need to contact your business customers to get confirmation from them if the DRC charge will apply, including confirming if the customer is an ‘end user’ or ‘intermediary supplier’. **You need to keep a record of their answer.**

What if I don't/can't get verification whether a customer is an end user or not?

If you are sure that your customer is an end user because you have provided similar services in the past, you can apply the normal treatment without asking them to confirm status.

If you are unable to confirm, the default position is to assume that a customer is an end user and to charge VAT; it is up to the customer to confirm their status to the supplier. If the treatment adopted is found to be incorrect, resulting in the reverse charge being applied incorrectly, HMRC will expect the customer to notify the supplier that it is an end user and request a corrected invoice. In the case of self-billing, a new invoice will have to be issued and the VAT will have to be paid to the supplier.

The DRC and VAT cash accounting – how does this work?

The *Cash Accounting Scheme* cannot be used for the supply of services that are subject to the reverse charge. You can still use the Cash Accounting Scheme for supplies that are not within the reverse charge. However, you'll have to use cash accounting for your purchases so you may find that the Cash Accounting Scheme no longer helps your cash flow. If this is the case, you can withdraw from the scheme.

The DRC and VAT flat rate scheme - how does this work?

Reverse charge supplies are not to be accounted for under the *Flat Rate Scheme (FRS)*. Therefore, users of the scheme will have to consider if it is still beneficial to them to continue in the FRS when VAT is not being paid to them on some or all of the invoices they issue. FRS users who receive reverse charge supplies will have to account for the VAT due to HMRC

OTHER IMPORTANT POINTS/RECAP

1. **Monthly returns** – If you are a subcontractor making a lot of sales subject to the DRC i.e. you don't charge VAT on sales, then you may end up being a repayment trader making net claims from HMRC. You can apply to HMRC to move from quarterly to monthly VAT returns in order to speed up repayment claims. You can do this online by signing in to your VAT account or you can write to HMRC, Variation Unit, Imperial House, 77 Victoria Street, Grimsby DN31 1DB.
2. **Mixed services** – If any service in a supply to a single customer is subject to the reverse charge, then materials or goods supplied with the reverse charge service will ALSO be subject to the reverse charge.
3. If a number of connected businesses collaborate together to purchase construction services, they are all treated as end users and the DRC does not apply to their purchases. For example, a property-owning group who buy services and recharge these to other group companies or their tenants will be end users.
4. **Adjustments** – Where there are adjustments, such as credit notes, refer to the HMRC website mentioned above for detailed guidance on how these are to be dealt with.
5. **Materials & services** – CIS applies to labour, not materials. This is not the same for DRC – the reverse charge applies to both materials and labour when materials are supplied with services. If materials are supplied separately, they are NOT subject to the reverse charge.

6. **Part paid invoices** – where an invoice is part paid at 1 October 2019, there is no need to change the original treatment i.e. reverse charge should not apply to the part unpaid and received after 1 October 2019.
7. **Employment businesses** – VAT reverse charge does not apply to supplies of staff or temporary workers provided by employment businesses (or umbrella companies) who are responsible for paying them.
8. **Supplier invoices** – Under the DRC, the supplier must show on their invoice the rate of VAT or VAT charge and specify on the invoice that the reverse charge applies – use wording such as ‘Reverse charge: customer to pay VAT to HMRC’.

When is the tax point for VAT for a single payment contract?

A tax point is the date the transaction takes place for VAT purposes. It can be the following:

- the tax point for VAT is the date that the service is performed or completed.
- If you issue a VAT invoice or receive payment before a service is performed or completed, VAT is due on the date of invoice or receipt of payment if earlier.
- If you issue a VAT invoice within 14 days of the service being performed or completed, VAT is due on the date of invoice.

What are the transitional arrangements at 1 October 2019?

For supplies that become liable to the VAT reverse charge, the VAT treatment is as follows:

- Tax point before 1 October 2019, normal VAT rules apply at the applicable VAT rate.
- Tax point on or after 1 October 2019, the DRC will apply.
- For authenticated tax receipts or self-billed invoices, the tax point is normally the date the supplier receives payment.

The table below explains the transitional arrangements for how the VAT treatment is determined for payments due on any supplies entered into your accounting system before 1 October 2019, but paid on or after 1 October 2019.

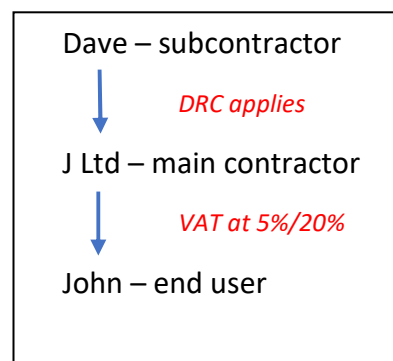
| Date entered in customer's accounting system | Date payment made | VAT Treatment |
|--|----------------------------|-------------------------|
| Before 1 Oct 2019 | On or before 31 Dec 2019 | Normal VAT rules |
| Before 1 Oct 2019 | On or after 1 January 2020 | Domestic reverse charge |
| On or after 1 Oct 2019 | On or after 1 Oct 2019 | Domestic reverse charge |

Retention payments - The tax point for the retention element of the contract is delayed until payment is received or a VAT invoice has been issued for it (whichever is earlier).

Example

Dave is a (subcontractor) and VAT registered. He has been contracted to do some work on a building by J Ltd, the main contractor, who is refurbishing the building on behalf of John, the owner. J Ltd is also VAT registered. In this case:

- Dave is the subcontractor and his customer is J Ltd.
- J Ltd is the main contractor, not an 'end user', because they will make an onward supply of construction services to John, J Ltd.'s own customer.
- John is the 'end user'.



When Dave raises his invoice to J Ltd, it will be subject to the DRC – he will not charge VAT to J Ltd. When J Ltd raises an invoice to John they will charge VAT at 5%/20% on the invoice.

Suppose the value of Dave's work, including labour and materials, is £10,000 – how will this be reflected in his VAT return and that of J Ltd after 1 October 2019 under the DRC scheme?

If you are under MTDfVAT, your accounting software will automatically put the entries in the correct places, PROVIDED it has been configured correctly. If you are not within MTDfVAT, and in any case, the entries will be as follows:

Dave's VAT return will only include the value of the sale in Box 6 (net outputs) of his VAT return – **Box 1 will not be applicable:**

- Box 6 – outputs - £10,000 – *on the date he receives payment if under cash accounting.*

J Ltd will do the reverse charge calculation with ONLY the following entries on their return (**Box 6 should not include any DRC supply**):

- Box 1 – output tax £2,000 (i.e. £10,000 x 20%)
- Box 4 – input tax - £2,000 (same figure as Box 1) – claims the VAT back
- Box 7 – inputs - £10,000 (net value of payment).

NB - J Ltd will account for the VAT to HMRC under the DRC scheme on the date they make payment to Dave, unless Dave has issued J Ltd with a tax invoice beforehand, in which case J Ltd has to account for VAT using the date of the invoice.

Other points to consider for both Dave and J Ltd

- Dave must ensure that J Ltd is both registered for the CIS (Construction Industry Scheme) and also has a valid VAT number.
- Dave must specify on his sales invoices the amount and rate of VAT that J Ltd must declare with the reverse charge i.e. 5% or 20% VAT.
- Dave should include wording on the sales invoice along the lines of: **“Reverse charge: customer to pay the VAT to HMRC.”**
- J Ltd must tell Dave if they are an end-user. It is the responsibility of J Ltd to do so. If they don't, Dave must charge VAT by default and pay it to HMRC.
- J Ltd is responsible for paying the reverse charge VAT to HMRC and the also the VAT they charge on the sales invoice to John, who will ultimately bear the VAT.

APPENDIX FLOWCHART

VAT: domestic reverse charge for building and construction services

Use this flowchart to see how you would decide whether to apply normal VAT rules, or apply the domestic reverse charge.

Do not use it for services supplied by employment businesses.

