



VAT Reverse Charge for Building and Construction Services

HMRC has published extended guidance on the new domestic reverse charge for building and construction services, which will be introduced on 1 October 2019. The new guidance seems to provide considerably more detail than was originally included with the draft legislation in December 2018. Since this is such a fundamental change to the VAT rules it seems likely there will be transactions by which the new rules will create disputes and confusion.

What is the domestic reverse charge (DRC)?

The DRC is a major change to the way VAT is collected in the building and construction industry. Instead of the requirement to pay VAT to a supplier the DRC requires the customer receiving the service to pay VAT to HMRC.

The new rules will only apply to individuals or businesses registered for VAT in the UK supplying specified services reported under the Construction Industry Scheme (CIS). The DRC does not apply if the service is zero-rated or if the customer is not registered for VAT in the UK. It also does not apply to services which are supplied to 'end users' or intermediaries connected with end users. There have been a number of updates to the previous draft guidance on the following matters:

- How to check whether the customer is VAT registered or CIS registered
- How and when it is necessary to check that a customer is an end user or an intermediary
- Changing VAT treatment in the middle of a contract
- Completing VAT returns
- Contracts spanning 1 October: the guidance outlines transitional rules for payments due on any supplies entered into accounting systems before 1 October 2019, but paid on or after 1 October 2019
- Where large contractors hold many contracts with a single subcontractor: if the DRC applies to more than 5% of those contracts (by volume or value) the HMRC guidance says the DRC may be applied to all the contracts

HMRC has advised businesses that they will need to prepare for the change by:

- Checking whether the DRC affects either sales, purchases or both
- Informing regular clients or suppliers



- Ensuring accounting systems and software are updated to deal with the DRC
- Considering whether the DRC will have an adverse impact on cashflow as the opportunity to use the amount of VAT paid, between the time it is received from the customer and the time it has to be paid over to HMRC, will no longer exist.

To assist you, we've prepared the following summary as a guide to the new legislation:

The new procedures are being introduced on 1 October 2019, and affect any VAT-registered construction business that does the following:

- Buys in construction services from other builders and makes an onward supply of those services to another customer e.g. where a subcontractor invoices the main contractor on a project, and the main contractor invoices the final 'end-user' client
- Sells construction services to other builders where the builders make an onward supply of the services to their customer

What is changing?

Under current rules, a construction company/builder charges VAT to their customer, collects the VAT from the customer and accounts for it in Box 1 of their relevant VAT return.

This is changing for supplies between VAT-registered builders. The construction company/builder will invoice their construction/builder customer without charging VAT and the customer makes the Box 1 entry instead on their own VAT return.

In effect, there will be no cashflow issue for the builder receiving services because the same amount of VAT declared in Box 1 will also be included as input tax in Box 4: i.e. a nil effect overall. This is formally known as a "reverse charge" procedure.

Why are HMRC making these changes?

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 because the supplier is never paid VAT in the first place.

Which sales are caught by the new rules?

The new reverse charge procedures will apply to the following transactions:



- The legislation refers to “specified services” but these do not apply to services supplied to non-construction businesses, such as a retailer having their premises improved or any other end-user customer or building owner;
- The reverse charge will also apply to any goods supplied by the construction company/builder as part of their work;
- Employment businesses are excluded from the new rules;
- The reverse charge is based on the rate of VAT that applies for the work in question but only supplies subject to either 5% or 20% VAT. Zero-rated sales are excluded.

Let’s give you an example:

Mike is an electrician, VAT registered as a sole trader. He is doing some work on an office block, invoicing the main contractor Steve for his work.

Steve is also VAT registered and will then invoice the building owner. Steve is not an “end-user” because he is making an onward supply of construction services to his own customer. He is an “intermediary supplier”.

The invoice raised by Mike will be subject to the new procedures ie. no VAT is charged. Let’s say the value of his work including materials will be for £5,000:

Mike’s VAT return will only include the value of the sale in Box 6 (outputs) of his VAT return:

Box 6 – outputs - £5,000

Steve will do the reverse charge calculation and make the following entries on his return:

Box 1 – output tax £1,000 (ie. £5,000 x 20%)

Box 4 – input tax - £1,000 (same figure as Box 1)

Box 7 – inputs - £5,000 (net value of payment made to Steve)

Items to consider:

Taking the Steve and Mike example a stage further, they each have their own responsibilities with the new rules.

Mike must ensure that Steve is both registered for the CIS (Construction Industry Scheme) and also has a valid VAT number.



Mike must also specify on his sales invoices the amount and rate of VAT that Steve must declare with the reverse charge ie. 5% or 20% VAT.

Mike should include wording on his sales invoice. There is no specific wording but HMRC provide examples of suitable wording as follows:

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

Where customers issue authenticated tax receipts or self-billing invoices HMRC's recommended wording is:

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

Steve must tell Mike if he is an "end-user" or "intermediary supplier". If he is an intermediary supplier, then Mike will not charge him VAT because the reverse charge applies.

It is important that Steve does not pay VAT incorrectly to Mike because HMRC could raise an assessment for the VAT that he should have declared, ie. as if the reverse charge had been done correctly.

Additional Considerations:

- Checks should be applied to ensure building contractor clients invoiced under the new rules are properly registered for VAT and are bona fide. Section 9 of HMRC VAT Notice 735: Domestic reverse charge procedure gives further information
- HMRC suggests that if there are any doubts about the credentials of a builder customer, then a deposit equal to the amount of VAT not being charged should be collected from the customer eg. if they have applied for but not received a VAT number
- VAT Notice 735 mentioned above gives examples of customer checks that should be considered at para 9.3.1

Penalties issued by HMRC for errors:

HMRC has confirmed that penalties will not be charged for mistakes with the new procedures up until 31 March 2020, the exception being if "you are deliberately taking advantage of the measure by not accounting for it correctly."