VAT: DOMESTIC REVERSE CHARGE

FOR BUILDING AND CONSTRUCTION SERVICES

coalesco
CERTIFIED ACCOUNTANTS

REVERSE CHARGE VAT

The way VAT is paid between businesses in the construction sector changed. Companies like yours who are VAT registered and CIS registered will no longer pay VAT to the majority of their subcontractors. The VAT will only be paid by construction companies to:

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- Firms who supply only labour and are employment businesses AND
- The merchants and companies that sell building materials without any fix

The payment of money between firms in the construction chain will pass 'reverse charged', and no VAT will be paid.

The aim is to collect VAT from the few contractors at the top of the construction tree, who interface with the customers, rather than numerous smaller subcontractors whom HMRC think are less reliable!

The diagram in Appendix 1 shows you the way reverse charge will affect the way money flows in the industry.

WHAT PAYMENTS ARE AFFECTED BY THE DOMESTIC REVERSE CHARGE?

After 1 October 2020, a payment must be invoiced/applied for under the reverse charge rules if:

- The payment is for construction services (the definition is the same as for CIS payments – see Appendix 2) and the customer/payer is CIS registered; AND
- Both parties to the contract, the payer and the recipient / the contractor and the subcontractor, are VAT registered; AND
- The payment will be standard rated or reduced rated. Zero-rated supplies will continue to be billed as they are now, but no VAT is chargeable because of the zero rate!

To check whether you should be requesting VAT using a normal invoice or should be reverse charging, see Appendix 3.To check whether an incoming invoice correctly charges VAT or is correct in reverse charging, see Appendix 4.

TWO MANDATORY CHECKS

It is also the responsibility of the customer to check whether the business is VAT registered to use the VIES system online: *click here*.

To check whether a customer is CIS registered to use the same verification system that you use for subcontractors. When you are asked if you have placed an order, tick the box to confirm – HMRC has agreed this 'workaround'. Some customers who are 'deemed contractors' because they commission more than one million pounds worth of construction work a year, may not be in the online system.

If you attempt to verify a customer and you cannot verify them, but they are likely to be a deemed contractor, you need to ask for: a letter confirming their UTR; a copy of a piece of HMRC correspondence; or a printout from their own verification system evidencing their UTR.

WHAT DOES A REVERSE CHARGE INVOICE LOOK LIKE?

Invoices sent after 1 October 2020 will need to contain wording explaining that they are reverse charge invoices and will look something like the example - see Appendix 5

They will not show VAT in the columns which calculate the payment to be made.

The example invoice is not prescriptive. Legally you do not have to show the VAT number of the customer, but it evidences that you have checked that they are registered and is good practice.

Your software system will probably not let you calculate the VAT that is being reverse charged and print it outside the accounting column as the example. Xero and FreeAgent do not allow this. If you can't show it, don't worry.
The recipient of the invoice will have to do the calculation themselves (or their software will!).

What is important is that your invoice does not charge VAT and clearly shows that it is a reverse charge invoice and S55A applies.

WHAT IS NOT COVERED BY THE REVERSE CHARGE - WORK FOR END-USERS

An 'end-user' is a term used in reverse charge law and needs to be thought about and be understood.

It is a business who will use the building or structure themselves in their own business either as a building to sell or to rent out or for their own use, e.g. as offices.

Development and property companies and house builders are end-users because they will rent or sell what they have commissioned. They deal in assets rather than supply construction services.

Another construction business who will add your work to their work and bill everything to a client as construction services is NOT an end-user.

In deciding whether you are working for an end-user, you must ask yourself who you are contracted with, who are you expecting to pay you. Do not think about the final client if you will not be directly contracted to or paid by the final client. Ask yourself, is the firm that you work for going to be the end-user of that building or construction activity?

SUPPLIES WITH REVERSE CHARGE AND NON-REVERSE CHARGE ELEMENTS

Looked at on a contract by contract basis a customer is either an end-user in a contract, or they are not. It is like a light switch, either on or off.

If part of a contract is for work that the customer will 'sell on' as construction services, or where they will not be an end-user, this will taint the entire contract, and they are NOT an end-user of a part. The whole contract must be reverse charged. The customer will be responsible for calculating and paying the VAT due.

WHAT DOES AN END-USER STATEMENT LOOK LIKE AND WHAT MUST IT SAY?

Do you need one if it is obvious that the customer is an end-user?

Sometimes it will be obvious that the customer is an end-user. For example, you are contracted with a manufacturing company to build a factory which they will use, you know the facts, and they know the facts. They are an end-user.

It is recommended that wording in the contract on the following lines would be sufficient to amount to an end-user statement:

"The customer/employer confirms that for the purposes of Section 55A VAT Act 1994 reverse charge for building and construction services, it is an end-user and should be charged VAT. The customer/employer will inform the contractor promptly if they cease to qualify as an end-user."

If wording like this is not in the contract, a letter from the customer/employer using the following words is sufficient:

"We are an end-user for the purpose of the Section 55A VAT Act 1994 reverse charge for building and construction services. Please issue us with a normal VAT invoice with VAT charged at the appropriate rate. We will not account for the reverse charge."

If end-user statements are given to you by customer/employers, you should retain them and know where to find them for an audit! If HMRC finds that a customer has failed to notify end-user status to their supplier, they will require the customer to account for and pay the VAT. Exceptionally they may need the customer to contact the supplier and request a corrected invoice.

WHAT IF AN END-USER STOPS BEING AN END-USER?

The simple position is never look back. The next invoice you issue or application you make will reverse charge. But it will not re-work the VAT on earlier invoices or payments, nor will you make any attempt to time apportion anything.

How can an end-user stop being an end-user? Imagine a developer owns a plot of land on which he intends to build a retail park which he will sell as warehouse units. He is an end-user because he will sell units; he will not supply construction services to anyone. The builder of the units is providing construction services, he checks the developer is CIS registered (he is a deemed contractor because he commissions more than one million pounds of construction work a year), he is VAT registered, and the supply is standard rated. The builder would normally reverse charge, but the developer gives him an end-user certificate.

But then the developer sells the whole site during construction to a major retailer but retains the contract to build the warehousing. He is still the builder's client, but he is not an end-user, and he must tell the builder that he is no longer an end-user.

At the point he is notified of a change from end-user status, the builder reverse charges all future invoices, and all payments outstanding. He does not rework historic paid invoices or time apportion anything as partly reverse charge and partly not. What has been done is gone, it is only future invoices, and applications for payment that will be reverse charged. No attempts at correcting the past should be attempted.

If in the example outlined, the building contract was assigned to the new owner then the new owner is likely to be an end-user. The new owner should be asked if they wish to supply an end-user certificate.

WHAT IF A CUSTOMER BECOMES AN END-USER?

If a customer who was being reversed charged suddenly sends an end-user certificate, you go with the flow! You start charging VAT on the next application for payment or invoice issued. You do not attempt any historical reworking or time apportioning.

SOME SPECIAL TYPES OF CUSTOMER

As a general rule if you think a customer like a utility company or a local authority is likely to be an end-user, always ask them if they would like to give you an end-user statement.

Local authorities

Local authorities are unlikely to be on supplying construction services. The supplies made to them are more likely to be part of works to an authority's own assets or provided as part of its statutory obligations, so it will be normal for them to be end-users. Always ask them if they are going to supply you with an end-user statement.

WHAT IS NOT COVERED BY THE DOMESTIC REVERSE CHARGE - THE SUPPLY OF BUILDING MATERIALS AND THE PURCHASE OF GOODS

The supply of building materials only, without any fix, is not within the CIS scheme, and so it is not covered by the reverse charge legislation. When you buy building materials, you will be charged VAT normally.

If you buy building materials with any services of fix or install, the contract is covered by CIS and reverse charge may be appropriate.

Caution – a subcontractor cannot merely split the invoice into two, one for materials and one for the fix. The CIS scheme and the reverse charge both focus on the nature of the supply under the contract. If a contract is for supply and fix it wholly falls within CIS and reverse charge.

THE CIS SCHEME AND VAT REVERSE CHARGE

Where a subcontractor is gross paid, he will be paid all the money due under the contract. If the VAT is to be reverse charged, he will be paid in full but without VAT.

Where the subcontractor is net paid for CIS, he receives payment for all his materials but is subject to a 20% deduction on the balance. Where the invoice is to be reverse charged, he is paid no VAT at all (none on the materials because they are part of a supply and fix contract).

Where the invoice is to carry VAT, the total invoice will be subject to VAT. Take care this will be unusual, and will probably be because your firm is itself an end-user in the transaction.

EXEMPTIONS FROM THE REVERSE CHARGE - EMPLOYMENT BUSINESSES

The reverse charge will not apply to payments made to employment businesses, a labour agency, a gang master which provides you with workers who are paid weekly or monthly by that business. Payments to an employment business will carry normal VAT. Payments are subject to the CIS scheme verification, gross or net payment, but they are not to be reverse charged.

TRANSITIONAL ARRANGEMENTS - INVOICES, APPLICATIONS FOR PAYMENT AND RETENTIONS

In VAT there is a concept called the tax point. This is the date which governs when VAT can be claimed or must be accounted for. The normal rule is that in construction, the tax point is the earlier of the invoice date or payment date. If you receive money on or before 30 September 2020, the payment will include VAT. If you receive an invoice dated before 1 October 2020 the invoice must show VAT. But let's look at invoices, applications and retentions separately.

Invoices

If an invoice is dated 30 September 2020 or earlier, the reverse charge does not apply; VAT should be shown on the invoice and VAT should be paid even if the payment is made after 1 October 2020.
If an invoice is dated on or after 1 October 2020 and all the conditions for reverse charging are met (Appendix 3 and 4) it should be reverse charged.

For the avoidance of doubt:

- If an invoice is for construction services AND
- Not to a labour provider or for building materials AND
- The supplier is VAT registered

The invoice should be reverse charged, and if it is not reverse charged, it should be returned to the business which issued it with a request to correct it and reissue it as a reverse charge invoice!

Payment in advance of paperwork

If a payment has been made in advance of an invoice and the payment was made in, say, September 2020, the payment is deemed to include VAT (because it has a tax point before the date of the change). If an invoice marked 'paid' is sent as a receipt after 1 October 2020 it should be marked 'Tax point xx September when payment received' and should show VAT to accord with the payment.

Self-billing invoices and authenticated receipts

HMRC have allowed a three-month concession intended to simplify the introduction of a reverse charge for applications for payment /authenticated receipts and self-billing.

When an application for payment is made under a contract which provides for staged payments, the application is not made as an invoice but as a letter.

When a subcontractor agrees to be self-billed, he agrees not to issue an invoice or an application for payment at all.

In both instances, a quantity surveyor or business manager acting for the contractor will agree that the work has been done to payment standard. They will enter the payment into the paying firm's system.

The HMRC concession says that if a business has entered a payment into their self-bill/staged payment system as valid for payment, before the 1 October 2020 and pays by 31 December 2020, the payment will carry VAT. If it is entered into their accounting system on or after 1 October 2020 or is entered before 1 October 2020 but is not paid until after 31 December 2020 (chaos, loss inefficiency?), it must be reverse charged.

Retention payments

The rules for reverse charge are the same as the rules for CIS. It does not matter when the work was done, the date which decides whether to reverse charge is the earlier of the invoice date requesting money or the payment date. Ignore when work was actually done!

VAT RETURNS - THE REVERSE CHARGE

The domestic reverse charge works by making the customer receiving the supplies liable to pay the VAT due to HMRC instead of paying the supplier. BUT it allows the customer to recover the VAT due on the supply subject to normal recovery rules. This means the same amount goes on both sides of the VAT return and costs the customer nothing.

All MTD compliant commercial software will automatically enter reverse charge transactions into the appropriate boxes in a VAT return (if the user enters the correct information!).

Sales

Box 1 of the VAT return will not include any output tax on sales to which the reverse charge has applied.

Box 6 will include the value of reverse charge sales.

Purchases

Box 1 will also include the notional VAT on purchases on which the reverse charge has been applied.

Box 6 will NOT include the value of such reversed charged purchases.

Box 4 will include the input tax on the reverse charged purchases.

Box 7 will include the net value of all purchases as normal.

See appendix 6 for a worked example of the above pre and post 1st October 2020 for the customer and supplier.

CASH ACCOUNTING - BUSINESSES THAT ACCOUNT FOR VAT ON THE BASIS OF PAYMENTS MADE AND RECEIVED RATHER THAN BY INVOICES ISSUED AND INVOICES RECEIVED

There is a problem in reverse charge legislation for businesses which cash account. Strictly the VAT on a reverse charge purchase should be accounted for in the accounts of the customer when the subcontractor or supplier issues an invoice, and not when they are paid, which is usually later.

Many firms in construction cash account, bringing into their accounting system only sums received and paid. The transition VAT return needs careful planning for no transactions to be missed or doubled up, and the cash flow impact requires significant planning.

FLAT-RATE SCHEME

Users of the scheme will have to weigh up whether it is still beneficial to them when VAT is not being paid to them on some or all of the invoices they issue. It is unlikely that the flat rate scheme will be a good option for any construction business.

REASSURANCE FROM HMRC

HMRC have accepted that the changes required to implement the reverse charge will be difficult for some. They will apply a light touch when dealing with errors that happen in the first six months, where businesses were trying to comply and have acted in good faith.

If you make a mistake, you must correct it as soon as possible, and no penalties will be charged. If HMRC believes the error was deliberate or that it was not corrected as quickly as was reasonable in the circumstances, they will issue a penalty.

WHAT IS THE LIKELY IMPACT ON FIRMS WHICH ARE PREDOMINANTLY SUBCONTRACTORS?

There is a cash flow impact on businesses that reverse charge because they will not receive the VAT they anticipate getting in during October, November and December 2020 unless they understand the above.

Many subcontractors may have 'old' VAT still to pay to HMRC for the quarter to say 30 October 2020 or 30 November 2020 when they are not continuing to receive VAT on payments arriving after 1 October 2020.

Subcontractors will also be paying VAT when they buy materials but will not be receiving VAT on the contracts they complete after 1 October 2020. The VAT paid on materials will be repaid once the subcontractor puts in a VAT return. Many firms in this position should consider whether to notify HMRC that they wish to change from making quarterly returns to making monthly returns. This will allow them to obtain quicker repayments of VAT.

The best time to move to monthly returns will depend on the business. If a taxpayer submits a quarterly return to 30 September 2020 and asks to change to monthly returns by 14 November 2020, October will be a monthly return as will all months after that. If the request was made by 14 December 2020 October and November would be a two month return period with monthly returns thereafter.

CHECKLIST

- ☑ Think about cash flow and prepare for no incoming VAT after October
- ☑ Will you need to become a monthly repayment trader?
- ☑ Prepare to revise the form of invoices and applications for payment, so they do not request VAT. You will need VAT invoices and reverse charge invoices.
- ☑ Train the person who issues invoices in reverse charge rules (if it is not you).
- ☑ Upgrade your software to handle reverse charge.
- ☑ Learn how to check VAT and CIS registration of customers
- ☑ Where will you file end-user statements that you need to retain?

WHAT IS THE LIKELY IMPACT ON THE CONTRACTORS WHO WORK FOR END-USERS AND CUSTOMERS?

In the past, the main contractors facing a client or end-user will have charged VAT but will have offset all the VAT that they have been invoiced by subcontractors in the calculation of the tax due to HMRC. After 1 October 2020, these main contractors will have to pay almost all the VAT they have invoiced to end users without much VAT incurred to set off.

Reminder - VAT becomes due once an invoice is raised whether or not the client or end-user has paid.

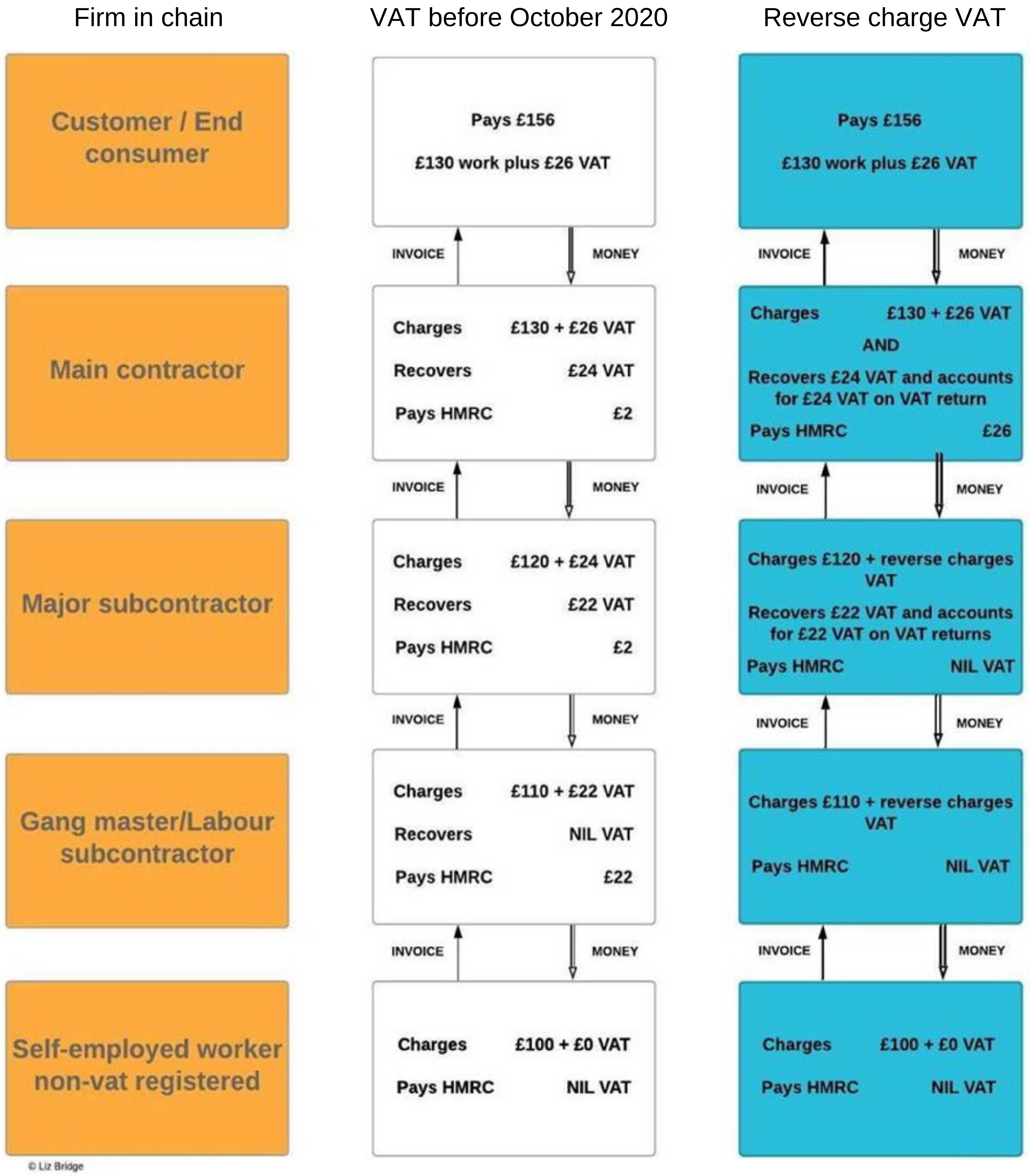
Contractors are also going to have to be vigilant in checking that they are not accepting and paying VAT to subcontractors after 1 October 2020. Contractors know they are VAT registered or CIS registered and that the supplies they are paying for are more than likely to be within the scope of CIS. Invoices received, and applications for payment should be reverse charged and those that are not should be queried.

CHECKLIST

- ☑ Check that your cash flow can cope with the changes in October 2020.
- ☑ Prepare new formats for invoices and applications for payment for any reverse charge work you do.
- ☑ Prepare end-user statements for your customers and ask them to sign and return them.
- ☑ Consider getting end-user statements into contractual terms.
- ☑ Watch VAT payment dates and be prepared to phone HMRC in advance if you cannot pay a liability.
- ☑ Consider whether to become a monthly repayment trader.
- ☑ Warn your subcontractors of the change to attempt to stop them invoicing for VAT after 1 October 2020.

APPENDIX 1

HOW REVERSE CHARGE WILL AFFECT THE WAY MONEY FLOWS IN THE INDUSTRY



APPENDIX 2

DEFINITIONS AND ACTIVITIES

Annex A: HMRC's core definition of "construction services" - this is the same wording as used for CIS:

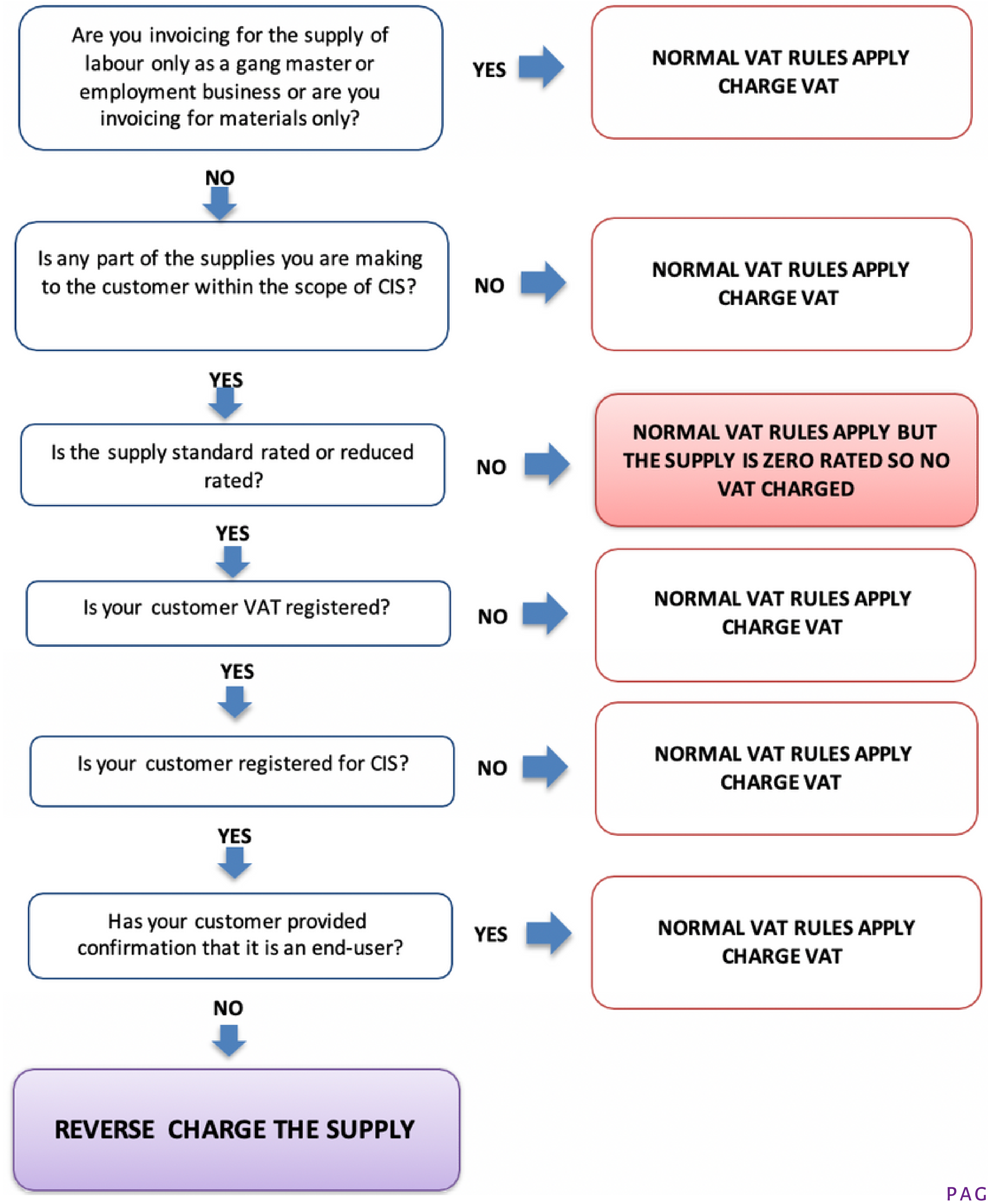
1. Construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations;
2. Construction, alteration, repair, extension or demolition of any works forming, or to form, part of the land, including (in particular) walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence;
3. Installation in any building or structure of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection;
4. Internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration;
5. Painting or decorating the internal or external surfaces of any building or structure;
6. Services which form an integral part of, or are preparatory to, or are for rendering complete, the services, 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.

Annex B: this is HMRC's list of activities which are not in themselves construction services, but are treated as construction services if they are provided in a package with services listed in Annex A:

1. Drilling for, or extraction of, oil or natural gas;
2. Extraction (whether by underground or surface working) of minerals and tunnelling or boring, or construction of underground works, for this purpose;
3. Manufacture of building or engineering components or equipment, materials, plant or machinery, or delivery of any of these things to site;
4. Manufacture of components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or delivery of any of these things to site;
5. The professional work of architects or surveyors, or consultants in building, engineering, interior or exterior decoration or the laying-out of the landscape;
6. The making, installation and repair of artistic works, being sculptures, murals and other works, which are wholly artistic;
7. Sign writing and erecting, installing and repairing signboards and advertisements;
8. The installation of seating, blinds and shutters;
9. The installation of security systems, including burglar alarms, closed-circuit television and public address systems.

APPENDIX 3

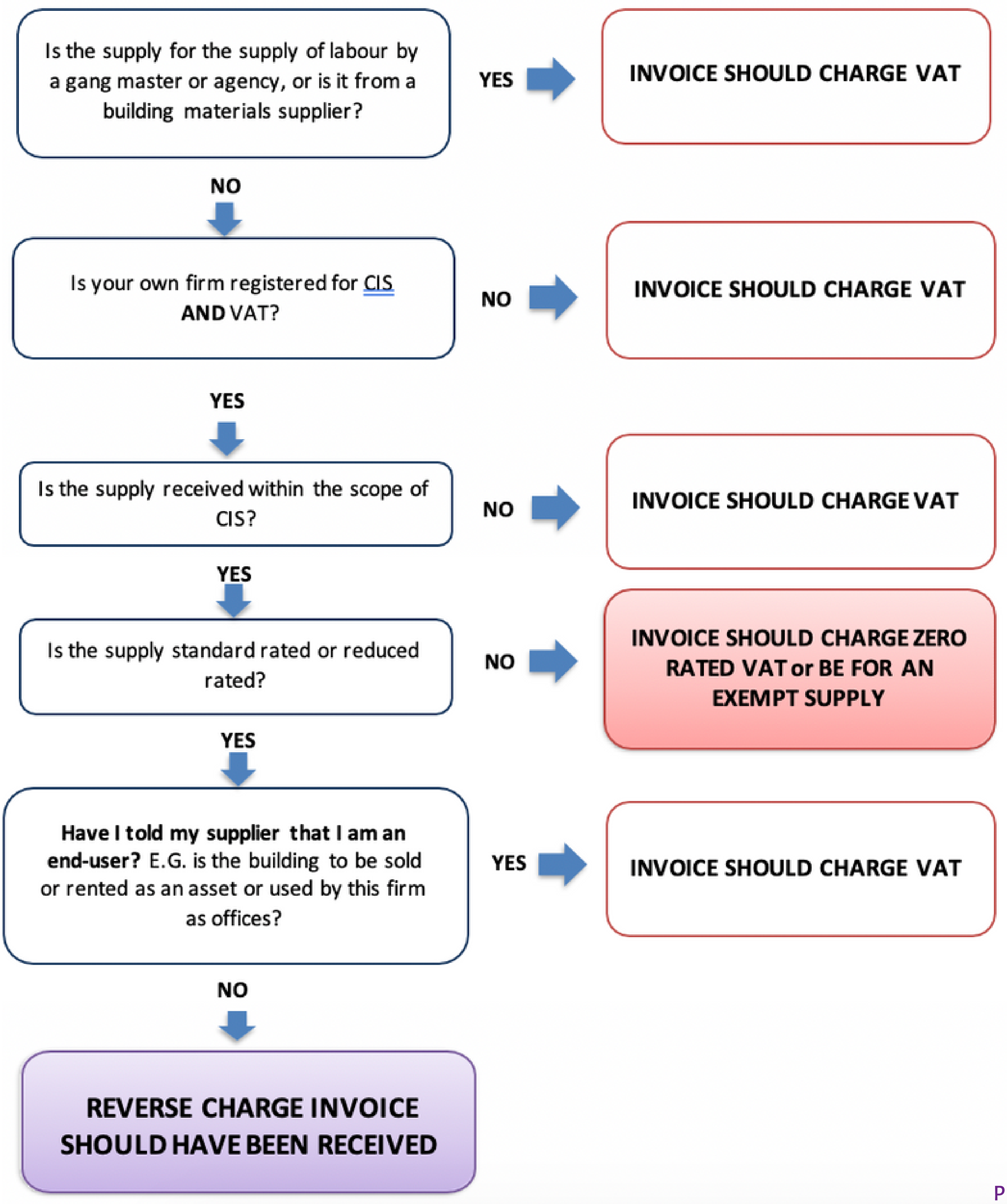
HOW REVERSE CHARGE WILL AFFECT THE WAY MONEY FLOWS IN THE INDUSTRY



APPENDIX 4

CHECKING AN INCOMING INVOICE

This chart is to help businesses receiving an invoice or an application for payment to check whether it is correct in charging VAT or reverse charging.



APPENDIX 5

SALES INVOICE

INVOICE

To:
Main Contractor

Address:

Customer VAT Reg. No:

Invoice No:
Invoice Date:

From: Sub-contractor
Address:

Supplier VAT Reg. No:

Description	Net £	VAT Rate	VAT £	Gross £
Construction of new housing	200,000	0%	0	200,000
Supply of ovens/hobs in new housing	20,000	20%	Domestic Reverse Charge Applies	20,000
Construction of retail premises	100,000	20%	Domestic Reverse Charge Applies	100,000
Non-residential to residential conversion	150,000	5%	Domestic Reverse Charge Applies	150,000
TOTAL	470,000		Payable	470,000

Customer to account to HMRC for the reverse charge output tax on the VAT exclusive price of items marked 'reverse charge' at the relevant rate as shown above. S55A VATA 1994 applies.

Standard Rate Output VAT subject to a reverse charge: £24.000 Reduced Rate Output VAT subject to a reverse charge: £7,500

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