

VAT. Major change for construction 2021

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It affects how VAT is accounted for, brings change to administrative procedures - and potentially impacts cash flow.

The VAT domestic reverse charge (DRC) for building and construction services takes effect from 1 March 2021. Designed to tackle VAT fraud in the construction sector, the measure has been postponed twice already. This time, however, it's for real.

What the reverse charge means

The essence of the DRC is administrative. It doesn't change the VAT liability: it does change who accounts for it.

From March 2021, it's the person receiving the supply of services, not the supplier of services, who accounts for the output VAT on those services. The recipient deducts VAT due on the supply as input VAT, subject to normal VAT rules. In most cases, no net tax on the transaction will be payable to HMRC. This new procedure will apply right the way up the CIS supply chain. But when you reach end users/intermediary suppliers, you default to normal VAT rules - so long as the end user/intermediary supplier correctly evidences their status.

Tip: previous planning

If you started planning for the DRC when it was originally due to be implemented, you will be pleased to know that the rules have not changed materially since then. The exception is an amendment requiring certain businesses (end users and intermediary suppliers, see below) to evidence their status to their sub-contractors.

HMRC provides technical guidance here <http://bit.ly/38oitR6>. In outline, the DRC applies to most supplies of building and construction services from 1 March 2021, which are:

- standard or reduced rated supplies
- where both parties are registered for VAT in the UK
- and payments for the supplies are required to be reported via the Construction Industry Scheme (CIS) (see below).

The DRC does not apply to:

- zero rated supplies
- services supplied to end users or intermediary suppliers, so long as these have provided written confirmation of their status to the supplier
- employment businesses supplying either staff or workers.

Specified construction services: broadly speaking, supplies covered by the DRC are those in the category of construction operations for CIS. The list is wide-ranging, including construction, alteration, repair, demolition of buildings or structures: painting and decorating internally or externally. HMRC technical guidance provides more detail.

But note that the DRC can cover goods, if supplied with specified services, and also that services excluded from the category of construction operations for CIS are also excluded from the DRC - if supplied on their own. But, if supplied with services subject to the DRC, the whole supply is subject to the DRC, as would also be the case for CIS.

HMRC guidance provides a 5% disregard if the DRC element of the supply is 5% or less of the value of the total supply.

It also indicates that if there has already been a DRC supply on a construction site, that any subsequent supplies on that site, between the same parties, may be treated as DRC supplies, if both parties agree. If any cases of doubt, where a recipient is registered for VAT and payments are subject to CIS, HMRC advises that the DRC should apply.

End users and intermediary suppliers: an end user, for DRC purposes, is a business or group of businesses, registered for VAT and CIS, which does not make an onward supply of the building and construction services received. It could be, for example, a large retail business having a trading store built for its own use.

An intermediary supplier is a VAT and CIS registered business connected or linked to an end user. To be considered connected or linked, it must either have a relevant interest in the same land where the construction work is taking place, such as a landlord and tenant; or be part of the same corporate group or undertaking.

Tip: important exceptions

Suppliers need to know if they are dealing with an end user/intermediary supplier so they can invoice correctly. If in doubt, ask.

End users/intermediary suppliers are required to identify themselves. As supplier, you can only default to traditional VAT accounting, rather than using the DRC, if the person you are supplying notifies you of their end user/intermediary supplier status on a specific contract.

Notification must be 'written' notification. HMRC interprets this to include electronic notification by email, as well as notification on paper and sent by post, or in a contract. It gives specimen wording to be used: see section 1 of the technical guidance <http://bit.ly/3pViddJ>. Notification should be kept as part of your business records.

Tip: no confirmation?

As supplier, if you don't receive written confirmation of such status, you must apply the DRC, and your customer will have to account for the VAT.

How to operate the charge

HMRC has useful flowcharts for both suppliers and purchasers in section 25 of its technical guidance <http://bit.ly/39mrrxy>.

Suppliers deciding whether the DRC applies to a contract must make some routine preliminary checks, establishing if the services to be supplied fall within the scope of the charge, and whether the recipient is someone to whom the charge applies.

Domestic customers: the DRC applies to supplies to VAT and CIS registered customers. If it's clear that you're supplying a private domestic customer, the

DRC isn't a consideration. You simply charge VAT as you have always done.

Other customers: for contracts with other customers, check that they have a valid VAT number, check their CIS registration with the CIS online service, and establish whether they are an end user/intermediary supplier.

Invoicing: there are specific invoicing requirements under the new rules.

If you supply a service subject to the DRC, as well as showing all the information usually required on a VAT invoice, you must:

- show on the invoice that the DRC applies, and that your customer must account for the VAT
- state how much VAT is due under the DRC (or, if the amount of VAT can't be shown, the rate of VAT), but
- VAT should not be included in the amount charged to the customer.

HMRC offers various forms of wording to use on an invoice (<http://bit.ly/2K3eslC>); the following all meet the legal requirement:

- reverse charge: VAT Act 1994 Section 55A applies
- reverse charge: S55A VATA 94 applies
- reverse charge: Customer to pay the VAT to HMRC.

It also provides an example of a reverse charge invoice <https://bit.ly/3hXqAaD>.

Your customer: having received your invoice, the recipient:

- doesn't pay output VAT to you on the supplies received from you
- accounts for the output VAT through its VAT return instead
- reclaims the VAT on supplies received as input tax, subject to normal VAT rules.

VAT returns

Suppliers don't enter any output tax on sales under the DRC. Only the net value of the sale is entered.

Those buying services subject to the DRC enter the VAT charged as output tax on the VAT return. The net value of the purchase is not entered as a net sale. But input tax on reverse charge purchases can be reclaimed, subject to the normal VAT rules.

Example

Safe as Houses Ltd is a VAT and CIS registered contractor. It uses Brickyard Bill, also registered for VAT and CIS.

Brickyard Bill issues an invoice showing the usual information required on a VAT invoice. But instead of charging VAT, it says the VAT reverse charge applies.

Safe as Houses Ltd does not pay VAT to Brickyard Bill. It accounts for the VAT on its own VAT return. It enters 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 net 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 DRC applies. It does not 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 net value of purchases in box 7.

Other compliance issues

There are transitional arrangements for authenticated tax receipts or self-billed invoices where arrangements span 1 March 2021, set out in section 9 of HMRC's technical guidance. Section 15 explains the treatment of credit notes and adjustments, including credit notes spanning the transition.

HMRC advises that it will 'apply a light touch in dealing with any errors made in the first six months

... as long as you are trying to comply with the new legislation and have acted in good faith'.

Suppliers: practical steps to take now

Preparation is key, and it will be important to take the necessary steps now to ensure a smooth transition to the new rules:

- build DRC decision-making into your routine for taking on new contracts
- work out how you will obtain the new information required from customers, such as verification checks
- make sure your accounting systems can calculate and report DRC supplies, and that invoices can specify that the DRC applies
- look at any training that your staff will need to cope with the new rules
- consider whether you would benefit from changing to monthly VAT returns to speed up possible future VAT repayments from HMRC
- if you use the Cash Accounting Scheme or Flat Rate Scheme, be aware that they cannot be used for the supply of services subject to the DRC. You may therefore want to review whether they are still useful to you
- review VAT and CIS compliance generally. The new rules are likely to mean construction business comes under closer HMRC scrutiny and it may become apparent that some construction services have not been correctly classified in the past.

In particular, there are cash flow implications for any business which will no longer hold output tax, and this will need to be factored into planning.

Please do contact us for further advice on the new rules, or financial management strategies to help your business adapt successfully.

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