

Domestic Reverse Charge

FOR BUILDING &
CONSTRUCTION
SERVICES

VAT: Domestic Reverse Charge for Building and Construction Services

The way in which VAT is to be applied to the supply of building and construction services has fundamentally changed as of 1 March 2021. Both suppliers and purchasers of construction services will see significant change as a result of the implementation of the VAT reverse charge for building and construction services. Have you considered what this means for the way in which you invoice your customers, the way in which you report transactions on your VAT returns and ultimately for the cash flow of your business?

In March 2021, the domestic reverse charge for building and construction services was introduced. The measure has been introduced by HMRC to tackle VAT fraud in construction sector labour supply chains which HMRC believe presents a significant risk to the Exchequer. A Policy Paper released by HMRC in 2018 indicated that HMRC believe that these measures will result in an Exchequer impact of c. £80m+ annually.

It is essential that businesses throughout the UK understand the new rules and prepare for what the change means for their business

both from a cash flow perspective and from an internal process perspective. Reviewing contracts to determine where the reverse charge will apply, ensuring accounting systems have been updated to deal with the changes and considering the impact on cash flow will ensure that your business remains VAT compliant. This guide contains some key points that need to be considered by construction businesses throughout the UK.



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 came 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.



What services are impacted by the changes?

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.” The reverse charge must be used for the following services:

- 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

If there is any doubt whether a type of work falls within the definition of building and construction services, as long as the recipient is VAT registered and the payments are subject to CIS, the reverse charge should apply.

What services fall outside the scope of 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

Key Considerations:

1) Am I providing services to an end user or an intermediary?

For reverse charge purposes, consumers that are VAT and CIS registered but do not make onward supplies of the building and construction services supplied to them, are end users. Intermediary suppliers are VAT and CIS registered businesses that are connected or linked to end users, such as being part of the same corporate group or sharing an interest in the same land where the construction works are taking place. The reverse charge does not apply to supplies to end users or intermediary suppliers where the end user tells their supplier or building contractor in writing that they are an end user or intermediary supplier. If this written confirmation is not provided, the supplier must assume that reverse charge applies.

2) Am I providing labour only construction services?

Where providing labour only, it is essential to determine whether this falls within the scope of labour-only sub-contractors or employment businesses supplying staff. Assuming all other conditions are satisfied, supplies by labour-only sub-contractors are subject to the reverse charge. Supplies by employment businesses are not subject to the reverse charge. Whilst there are a number of considerations, the simplest way to tell the difference is:

- Supply of labour-only construction services- the business supplying the labour will be responsible for overseeing the completion of the work carried out by the workers;
- Supply of staff- the customer that receives the workers will be responsible for overseeing the completion of the work carried out.



3) Do I make supplies, a portion of which are subject to reverse charge and a portion of which are subject to the normal VAT rules?

If the reverse charge part of the supply is 5% or less of the value of the total supply, this can be disregarded and normal VAT rules will apply. This means that normally if any of the services in a supply are subject to the reverse charge, all other services supplied will also be subject to it. This means that supply and fix works will typically be subject to the reverse charge because the services and goods are part of one supply for VAT purposes.

This may arise where a joiner constructs a staircase offsite (typically outside the scope of the reverse charge) and installs the staircase onsite (within the scope of the reverse charge). This contract will be subject to the reverse charge even if the charge for installation is only a small element of the overall charge (subject to the 5% disregard).

HMRC have also indicated that if a business enters into 2 separate contracts with the same supplier for works within the scope of CIS and the works are to be provided at the same time and on the same site, this will be viewed as a single supply for VAT purposes and the reverse charge will apply to both contracts (subject to the 5% disregard).

4) Does the reverse charge apply to additional supplies provided which fall outside the scope of the original contract?

HMRC provide the example of spares provided after the completion of a supply and fix contract. Guidance indicates that if the original contract did not provide for the supply of spares this is a materials-only supply outside the scope of CIS, therefore, normal VAT rules apply. However, if the original contract provided for the supply of spares and the original contract is subject to the reverse charge the supply of spares will also be subject to the reverse charge.

5) What if I am a non-established taxable person making or receiving taxable supplies?

Where a non-established taxable person makes supplies of construction services to a person belonging in the UK who is registered for UK VAT, it's the customer who must account for the VAT. If those services are made to customers who are not VAT registered in the UK, then normal VAT rules will apply.

If UK suppliers provide building & construction services to a non-established taxable person who is registered for UK VAT, the reverse charge will apply subject to the normal end user rules. The non established taxable person will have to account for VAT on their UK VAT return.



How will these changes impact me practically?

Changes to cash flow & monthly returns:

Where the reverse charge applies, you may no longer receive VAT on your sales. This means that the gross value of the payments coming into your business will be reduced and businesses need to consider the impact of this on their day-to-day cashflow. It may also mean that your business will make net repayment claims to HMRC and as such, you may wish to move to monthly VAT returns.

Changes to the way VAT is applied by suppliers of building & construction services:

Where the reverse charge applies, suppliers must not enter any output tax and only need to enter the net value of the sale. No VAT will be due on payments from customers. Whilst VAT on purchases subject to the domestic reverse charge will not be included in Box 1 of the VAT return, the net value of the sale must be entered in Box 6 of the VAT return. Suppliers must meet a number of invoicing requirements:

- show all the information required on a VAT invoice;
- make a note on the invoice to make it clear that the domestic reverse charge applies and that the customer is required to account for the VAT;
- clearly state how much VAT is due under the reverse charge, or the rate of VAT if the VAT amount cannot be shown, but the VAT should not be included in the amount charged to the customer.

Changes to the way VAT is applied by purchasers of building & construction services:

Where the reverse charge applies, suppliers buying services must account for the VAT due on the sub-contractors services in your VAT return. You will be entitled to reclaim input tax on your reverse charge purchases, subject to the normal recoverability rules. VAT accounted for under the reverse charge is likely to impact Box 1 and Box 4 of the VAT return. For customers that are fully taxable, we would not expect the reverse charge to have an impact on their VAT liability. The net value of purchases should be included in Box 7 as normal. Most accounting packages should be able to deal with reverse charge transactions by posting to a specific tax code.

Impact on VAT schemes used:

You cannot use the VAT Cash Accounting Scheme for supplies of services that are subject to the reverse charge.

Reverse charge supplies should not be accounted for under the Flat Rate Scheme. Flat rate scheme users will have to account for the VAT due on reverse charge supplies and recover it simultaneously on the same VAT return. This will mean that users of the scheme will have to consider if it is still beneficial to them when under the scheme they cannot recover VAT incurred on purchases of materials, overheads etc.



Key actions:

- If supplying services to an end user, ensure that you have received notification of end user or intermediary status. Notification can be made: a) on paper and sent by post; b) electronically in an email; c) in a contract. The notification should be kept as part of normal business records and show clearly what supplies are covered;
- For businesses that often deal with end users, a practical way of dealing with the question of end user status is for the business to include a statement in their terms and conditions to say they will assume that their customer is an end user unless they say they are not. This places a responsibility on the customer to respond if this is not the case.
- If in any doubt, you should always ask the customer whether they are registered for VAT and CIS.

You can check that your customer's VAT number is valid and belongs to them on the following website: <https://www.gov.uk/check-uk-vat-number>. If you are CIS registered you will also be entitled to use the CIS verification system: <https://www.gov.uk/use-construction-industry-scheme-online>

- **Transitional rules for self-billed invoices:** If supplies of building and construction services were entered into your accounting system before 1 March 2021 and the payment date will be on or before 31 May 2021, traders ought to use the normal VAT rules. For supplies entered into your accounting system before 1 March 2021 with a payment date on or after 1 June 2021, the domestic reverse charge should apply. For all building and construction service supplies entered into your accounting system on or after 1 March 2021, the domestic reverse charge should be used.

- Traders need to review each contract for building & construction services to determine if reverse charge applies. The following are key exclusions from the scope of the reverse charge provisions:

1. Zero-rated supplies. This extends to standard rated items which are included in zero-rated supplies, for example the supply and incorporation of ovens and hobs in new build housing. If you supply only standard rated services for new build housing, the reverse charge will apply;
2. The hire of goods only (i.e. without an operator) is not within the scope of CIS and therefore the reverse charge does not apply to the hire charge;
3. Supplies of construction services to utility businesses will typically fall outside the scope of the reverse charge provisions because they are the construction, repair or alteration of the utility company's physical assets. This would apply, for example, to the provision of a connection to a utility network or diversionary works to allow for the relocation of a network;
4. Supplies of construction services to local authorities and other public bodies will also typically fall outside the scope of the reverse charge as the end user exclusion will usually apply. This is because most supplies will either be related to works to the public body's property and land or provided to the public body so it can discharge its responsibilities under a special legal regime. In either of these scenarios the public body would not be making an ongoing supply of construction services and so the reverse charge provisions would not apply.



Utilise the guidance available:



How to use the VAT reverse charge if you supply building and construction services - GOV.UK (www.gov.uk)



Check when you must use the VAT reverse charge for building and construction services - GOV.UK (www.gov.uk)



VAT reverse charge technical guide - GOV.UK (www.gov.uk)



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