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DOMESTIC REVERSE CHARGE FOR VAT

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ROBSON / LAIDLER

ACCOUNTANTS



Disclaimer

This article is provided for illustrative purposes only and specialist advice should be taken by businesses about their specific circumstances. As the legislation is not in force at the time of writing it is likely that clarifications or amendments to certain aspects will soon be issued.

Though every care has been taken when preparing this material, the author accepts no responsibility for any losses arising to any business or entity acting, or refraining from acting, as a result of the material contained herein.

Introduction

The domestic reverse charge (DRC) relates to certain construction services and associated supply of goods. DRC legislation is due to come into force with effect from 1 March 2021.

DRC will not affect supplies made by subcontractors that are not VAT registered.

DRC will not affect supplies where payments do not need to be reported through the construction industry scheme (CIS).

If you are a VAT registered subcontractor providing services that fall within the scope of CIS then DRC potentially applies to your business. If DRC applies this is regardless of whether you receive gross payments, 20% or 30% deductions for CIS purposes.

In the context of this article 'subcontractor' refers to the supplier and 'contractor' refers to the customer in terms of the trading relationship.

DRC does not apply to zero rated services such as construction of new dwellings.

DRC will only affect supplies where the rate of VAT would be either reduced rate (5%) or standard rate (20%) and covers both services and associated materials provided.

Most accounting software packages can, or will soon be able to, appropriately deal with creation of appropriate invoices and recording of data in respect of DRC transactions.

DRC affects VAT treatment and layout of invoices for charges made by subcontractors to contractors. As the onus is on the subcontractor to deal with these matters correctly it is sensible, where they consider DRC will apply, for them to verify the VAT and CIS status of customers.

■ VAT numbers can be verified at: www.gov.uk/check-uk-vat-number

■ CIS status can be verified at: <https://www.gov.uk/use-construction-industry-scheme-online>

Evidence of these verifications should be maintained in case any queries arise at a later date.

It is also important for contractors to ensure that the VAT charged to them has been correctly treated. If DRC has not been applied when it should have been and a contractor recovers input VAT charged to it, HMRC will have power to make an assessment for the output tax of the same amount that 'should' have been declared had the DRC been correctly dealt with. If this happens the contractor may be able to mitigate any loss through having the subcontractor rectify the position. However, if the subcontractor has ceased trading or is one of the businesses in the sector that HMRC feel are defrauding the taxpayer then the contractor could easily end up footing the bill for what could otherwise be seen as an innocent oversight.



HMRC technical guidance around this area can be found at:

<https://www.gov.uk/guidance/vat-reverse-charge-technical-guide>

The technical guidance goes into detail on a number of fairly rare circumstances that may crop up and there are still likely to be many situations that require further clarification and will only come to light post implementation.

These useful one page flowcharts are a great starting point when assessing if DRC applies:

(1) For Subcontractors making supplies:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878587/Annex_1_-_VAT_domestic_reverse_charge_for_building_and_construction_services.pdf

(2) For contractors/customers receiving supplies:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878594/20.01.15_annexe_2_customer_flow-chart.pdf

This brief article does not cover the specific entries to be made on VAT returns.

Do the 'normal' VAT rules or 'new' DRC rules apply for supplies around the implementation date?

Standard VAT rules generally apply in determining where the tax point falls – pre 1 March 2021 for the 'normal' VAT treatment or after this time for the 'new' DRC rules.

Self-billing and authenticated receipts arrangements tend to have a tax point based on when the subcontractor receives payment from the contractor. If an invoice is entered onto your accounting system before 1 March 2021 then the date of payment is key as to whether DRC will apply:

- Payment date before 31 May 2021 – use normal VAT rules
- Payment date on or after 1 June 2021 – DRC applies

HMRC recommends that where there is doubt as to whether the work falls within DRC then DRC should apply, provided that the contractor is VAT registered and payments subject to CIS.



Different VAT schemes

Flat rate scheme

DRC supplies are not included in the flat rate scheme but businesses would still be restricted from reclaiming input VAT under this scheme. Most affected businesses are likely to benefit from reverting to normal VAT accounting to enable input VAT recovery.

Cash accounting for VAT

VAT cash accounting cannot be used for DRC supplies.

Many businesses making predominantly DRC supplies may find it beneficial to move from cash accounting to the standard VAT scheme in order to be able to reclaim input VAT from suppliers sooner to help cash flow.

Partial exemption VAT

DRC supplies will continue to be taxable supplies for VAT purposes and businesses need to ensure that they correctly attribute this when performing partial exemption calculations.

Contractors receiving DRC invoices also need to ensure that they correctly record the reverse charge on their VAT returns and correctly attribute the input VAT to ensure that an appropriate VAT position is maintained.

Cash flow

Many subcontractors making DRC supplies may soon find that they suffer cash flow difficulties as a result of DRC. This is because they would previously charge output VAT, receive this from their customers and then 'hold' this money until the VAT liability fell due for payment. The 'holding' of this money provides a cash buffer for many businesses which will cease after DRC is implemented.

If sub-contractors are likely to start receiving VAT refunds as a result of the DRC they may find it beneficial to move to monthly VAT returns to improve cash flow. The additional administrative burden of monthly reporting would have to be weighed up against cash flow considerations.

Some contractors will actually find that their cashflow position may improve as a result of DRC as they will no longer be paying VAT out to subcontractors on work done before recovering this as input VAT at the end of the quarter.

How do I know if services fall within the scope of CIS?

This will generally relate to services provided by subcontractors to contractors. In the vast majority of cases it will be clear cut whether activities fall within the scope of CIS. Subcontractors receiving payment after 20% or 30% CIS tax has been deducted will know if customers are declaring their invoices through CIS by the fact that these deductions have been made. For subcontractors who receive gross payments they may need to liaise with the contractors they are servicing if there is any doubt whether those services will be reported through CIS.

Contractors will be either businesses carrying out construction operations or businesses/persons spending in excess of £1m per annum on construction operations (unless End User status applies as set out on the next page).

Services supplied by professionals such as architects and engineers are exempt from CIS.

Employment businesses supplying construction workers will generally not be within the scope of DRC as their supply is that of staff rather than of construction services. This exception can

apply even if the supplies made by the employment business falls within the scope of CIS. HMRC guidance outlines its opinion regarding the distinction between employment businesses (exempt from DRC) and labour-only contractors (where the supplies would fall within DRC).



What is an 'End user'?

End users are effectively the final recipient in the supply chain of building and construction services. End users will usually either:

- Make use of the buildings/structures that have been created for their own purposes, or
- Sell the buildings/structures that have been created

DRC does not apply to services provided to end users. This exception applies provided that the end user confirms this status in writing to the subcontractor.

Examples of end users would be:

- A pharmaceutical company for whom a new factory has been built that it will commence production in.
- A property developer – on the basis that it will only ever sell completed properties rather than making any supply itself of construction services
- Property rental businesses

End users may not wish for this exception to apply, especially if this would hurt its cashflow position. By not confirming their end user status to subcontractors in writing this will prevent the exemption from being applied.

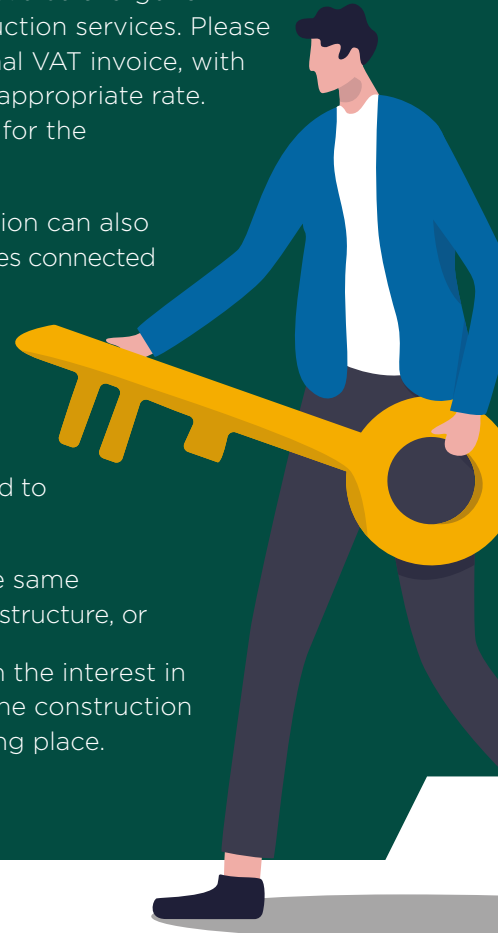
HMRC's example of the wording to use to confirm end user status is:

'We are an end user for the purposes of 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.'

The end user exception can also apply to intermediaries connected with end users.

These intermediary suppliers would need to be VAT and CIS registered businesses connected to the end user by:

- Being part of the same corporate group structure, or
- Having a share in the interest in the land where the construction services are taking place.



Mixed supplies

If any services on an invoice are subject to DRC then ALL items on the invoice are subject to the DRC, UNLESS the value (net of VAT) of the DRC services are less than 5% of the total net value of the invoice then the use of DRC in respect of that invoice is optional.

Where DRC supplies are made on a site, the subcontractor and contractor can agree that all supplies made between them on that site are subject to DRC for convenience.

HMRC recommends that where there is doubt as to whether the work falls within DRC then DRC should apply, provided that the contractor is VAT registered and payments subject to CIS.

Where more than one contract is entered into between a subcontractor and contractor for works at the same time, on the same site and at least some of the work falls within DRC, DRC will apply to all contracts (subject to the 5% disregard noted above) as they form a single supply for VAT purposes.

Key takeaways

- Ensure you are aware whether your business is making or receiving supplies that may fall within DRC
- If your business is affected speak with other affected businesses in your supply chain to ensure that there is agreement about how the changes will take effect
- Plan the impact this is likely to have on cashflow and consider whether additional financing is required or whether changes in your VAT scheme or moving to monthly VAT reporting is appropriate
- Check that your accounting software is up to date for the changes and then check that initial transactions are being pulled through appropriately
- Ensure appropriate documentation is held that you may need to rely on and check that invoices record the appropriate information
- If in doubt refer to your professional adviser

On the remaining pages are various examples of common scenarios likely to arise.



Examples

All references made to DRC refers to the invoices raised from the subcontractor to the contractor. It is assumed that subcontractors and contractors are all CIS and VAT registered.

1) Professional services



DRC does not apply here as these professional services are outside of the scope of DRC.

2) Sales that are zero rated for VAT purposes



DRC does not apply here as this activity is zero rated for VAT purposes. In this scenario it does not matter who the customer is.

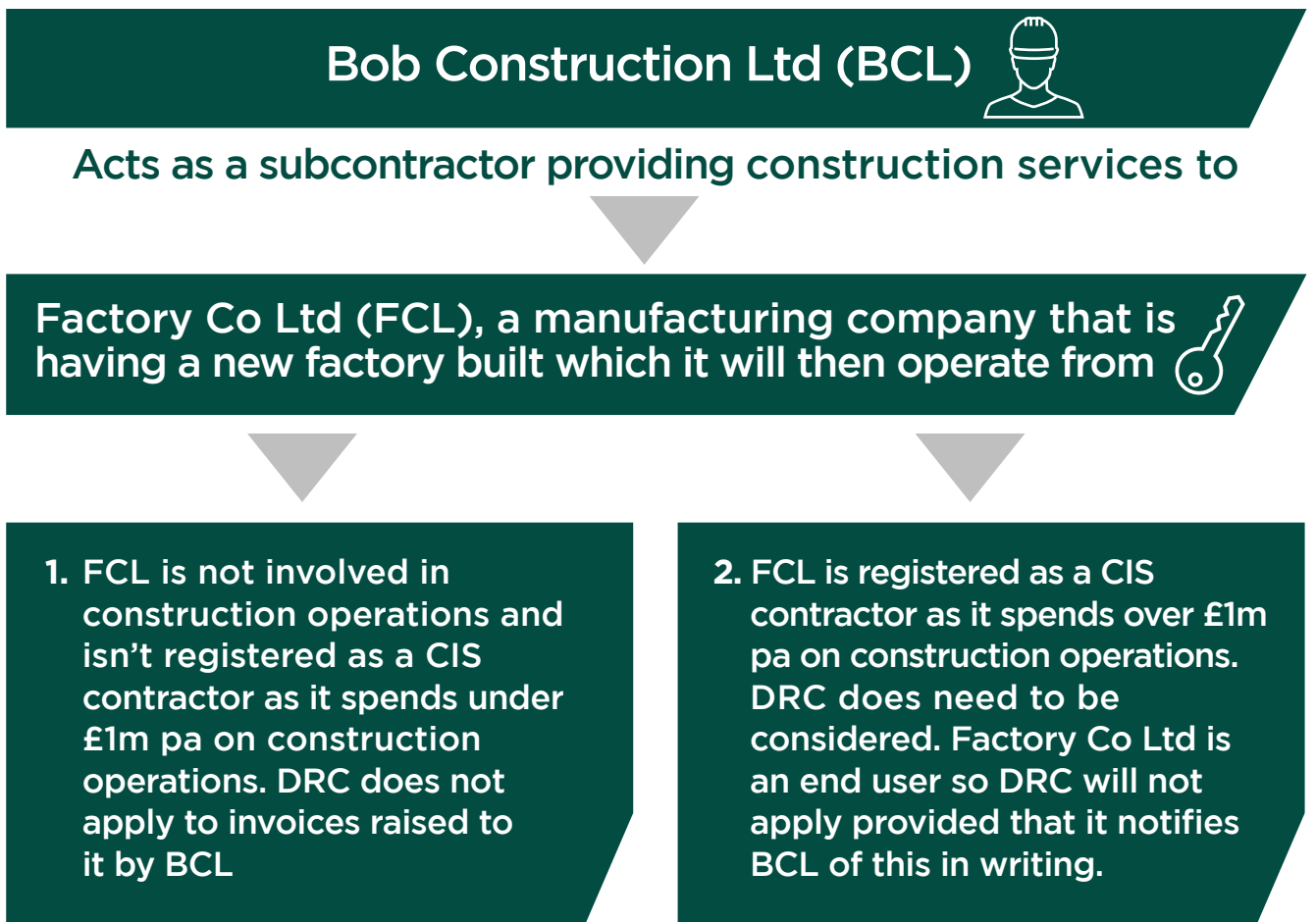
Sections 16 and 17 of the detailed HMRC guidance covers new build housing and specific situations which require special consideration, including:

- Supply and fix of goods not ordinarily incorporated in new build housing. Residential conversions and refurbishments are also covered.

- Hire costs, with or without an operator

These specific points are likely to cause some confusion, especially where there are mixed supplies and possible uncertainty as to whether certain activities fall under CIS.

3) Construction services provided to an end user



4) Services provided that are standard or reduced rate VAT

Sheila's Subcontractors Ltd (SSL)



Acts as a subcontractor providing construction services to

A construction company, Mortarco, that is renovating a property for resale



Mortarco is involved in construction operations and as such is registered as a CIS contractor. If Mortarco is purely going to sell the property once the renovation is complete it will not be making any onward supplies of construction services. For this reason Mortarco is an end user. so DRC will not apply provided that it notifies SSL of this in writing.

Mortarco is involved in construction operations and as such is registered as a CIS contractor. If Mortarco itself is a subcontractor on the project for another construction company, Mongoose Homes Ltd that owns and will sell the property then:

If Mortarco is not an intermediary connected with Mongoose Homes Ltd then DRC must apply to invoices raised to it by SSL. End user status cannot apply to services provided to Mortarco.

If Mortarco is an intermediary supplier connected to Mongoose Homes Ltd, for example they are both subsidiaries of the same group, then DRC will not apply provided that SSL are notified of this end user status in writing.

Certain property renovations in these circumstances would ordinarily be services provided at the reduced 5% rate of VAT, rather than at the standard 20% rate – this does not matter for consideration of DRC as DRC applies to both reduced and standard rated supplies.

5) Employment business providing construction workers

Sanjay Personnel Ltd (SPL)



Is an employment business providing construction workers to:

Build Contractor Ltd (BCL), a construction company on a major construction project. BCL is not an end user nor an intermediary supplier for end user purposes.



The supply by SPL is that of staff who are effectively managed by BCL in their day to day operations and are paid an hourly rate for work done. For DRC VAT purposes SPL is not providing any construction services. DRC does not apply to invoices raised to BCL by SPL.

If SPL provide staff with their on site activities and performance being overseen by SPL and SPL is paid by reference to the amount of work completed then the nature of these services would be considered to be provision of construction services, rather than purely provision of staff. DRC would apply to invoices raised by SPL to BCL.

It will often be clear whether the engagement relates to pure provision of staff or provision of construction services. There will inevitably be some instances where this becomes a grey area and careful consideration will be required of all pertinent factors.

6) Mixed supplies

Tony is a self employed builder



Provides labour and materials on a development to:



Shovel Developments Ltd (SDL), a construction company on a construction project. It is ascertained that some of the work provided falls within the scope of DRC



Tony invoices SDL £10k for activities falling under DRC and £2k for activities not falling under DRC. The full £12k invoiced must be treated as being subject to DRC



Tony invoices SDL £3k for activities falling under DRC and £100k for activities not falling under DRC. The full £103k invoiced can be subject to normal VAT rules, with DRC not applying due to the 5% disregard rule. In this situation it is still permissible to apply DRC and the parties can agree that all invoices are subject to DRC for ease of administration

Even if Tony enters into two contracts with SDL in relation to the project – say, one for labour services and one for supply of materials – assuming that the different aspects are to be provided on the same site, at the same time then if any element falls within the scope of DRC then all invoices raised should be subject to DRC (unless the 5% disregard can apply).

WANT TO KNOW MORE ABOUT THE DOMESTIC REVERSE CHARGE FOR VAT? /

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