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VAT Domestic Reverse Charge - a guide



Legislation Background

From 1 March 2021 a **domestic VAT reverse charge** will apply to certain types of building work (by application of The Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019). The measure is being introduced to reduce perceived VAT fraud but carries a number of risks for business.

Time Line

- HMRC technical consultation on draft legislation and impact - **Summer 2018**
- Legislation and Guidance - **November 2018**
- Introduction originally planned for **1 October 2019**
- Introduction delayed until **1 October 2020**
- Introduction now **1 March 2021**



Reverse Charge Mechanism



The reverse charge mechanism is not new; a reverse charge has been in place for services acquired outside the UK for many years, and the same mechanism has applied to sectors such as mobile phones, computer chips, emissions allowances, gas and electricity, telecommunication services and renewable energy certificates.

Under the reverse charge the customer receiving the supply of specified construction services charges itself VAT and accounts to HMRC for that VAT - the supplier does not charge, collect, or account to HMRC for VAT. For a fully taxable business, the effect is that VAT is charged at the date of the return, on that return, and recovered immediately on that return.

Affected businesses

The reverse charge applies to construction services supplied between contractors and sub-contractors only (including sub-contractor to sub-contractor supplies); it does not apply to services provided to the end user.

CONSTRUCTION SERVICES

The scope of construction services is wide and based on “construction operations” for CIS purposes.

The term therefore includes construction, alteration, repair, extension or demolition of buildings or civil engineering works, installation of heating, lighting etc. and works preparatory to, or to complete, such works. It also includes ‘painting and decorating the internal or external surfaces of any building or structure’.

Although the definition is based on the CIS definition, it is not actually linked to CIS deductions or similar - the reverse charge applies to those with gross payment status as well.

- If the services supplied include elements that are construction services, and elements that are not, the whole supply is treated as a supply of construction services for the purposes of VAT and the reverse charge.
- If goods are supplied with construction services, then the reverse charge covers the entire amount paid (for the goods as well as the services). Goods purchased separately from any services are not covered by the reverse charge and so will attract VAT at the applicable rate as normal.

Important note

This treatment of goods for the purposes of the reverse charge is different to CIS, where the costs of any materials supplied are not included in the calculation of any CIS tax deduction.

When the government announced a further five-month delay to the introduction of the domestic reverse VAT charge for construction services it also announced a change to the legislation when it does come into force. For businesses to be excluded from the reverse charge, as they are end users or intermediary suppliers, they must now inform their sub-contractors that they are end users or intermediary suppliers (Revenue and Customer Brief 7).

END USER

For reverse charge purposes, consumers and final customers are called end users. They're businesses or groups of businesses, that are VAT and Construction Industry Scheme registered but do not make onward supplies of building and construction services supplied to them (VAT reverse charge technical guide - 24 September 2020).

INTERMEDIARY SUPPLIERS

Intermediary suppliers are VAT and Construction Industry Scheme registered businesses that are connected or linked to end users. If intermediary suppliers buy construction services and re-supply them to a connected or linked end user, without making material alterations to supplies, they're all treated as if they're end users and the reverse charge does not apply.

To be connected or linked to an end user, intermediary supplies must either:

- Have a relevant interest in the same land where the construction works are taking place, for example, landlord or tenant; or
- Be part of the same corporate group or undertaking as defined in section 1161 of the Companies Act 2006.

The reverse charge does not apply to supplies to intermediary suppliers where the intermediary supplier notifies their supplier or building contractor in writing that they're intermediary suppliers. Intermediary suppliers can refer to themselves as end users (VAT reverse charge technical guide - 24 September 2020).



EMPLOYMENT BUSINESSES SUPPLYING CONSTRUCTION WORKERS

Employment businesses are treated differently for the purpose of the reverse charge. Supplies by employment businesses are not subject to the reverse charge, even if those supplies are in the scope of CIS (VAT reverse charge technical guide - 24 September 2020).

Risks

CASH FLOW

HMRC clearly state in the Revenue and Customer Brief 7 (5 June 2020) that ‘there will be a negative impact on cash-flows for many affected businesses, as they will no longer get VAT payments from customers for services where the reverse charge applies’.

CONFUSION

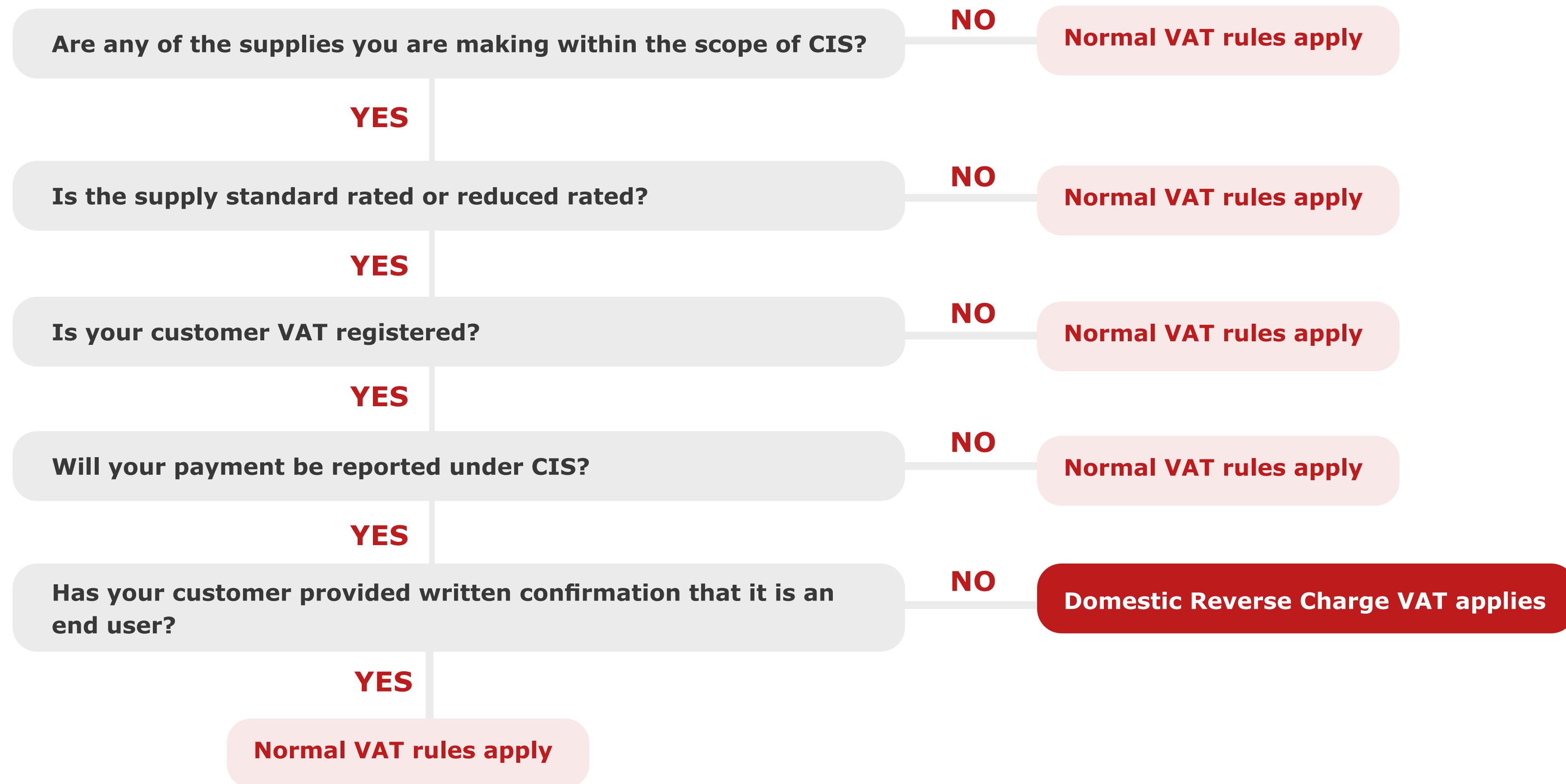
Before the deadline was pushed back to 1 March 2021, The Guild was contacted by a number of employment businesses concerned that their clients were notifying them that they would refuse to pay invoices that included VAT. If this is repeated following 1 March 2021 some employment businesses may encounter cash flow problems as clients withhold VAT which the employment businesses will have to pay over to HMRC.

SYSTEMS

Accounting systems need to be adapted to deal with the new VAT requirements. A number of accounting software suppliers have built in the changes to their products and businesses should ensure that the version of the accounting software they are using is able to meet the reverse charge requirements.

VAT Rules v Domestic Reverse Charge

Use the flowchart below to check whether to apply the normal VAT rules or the domestic reverse charge.



How The Guild can help you

As a highly-respected sub-contractor and intermediary in the contractual chain, The Guild strategically places itself between its clients and sub-contractors. We provide the accounting and construction industry with the peace of mind that comes with knowing that the procurement of self-employed talent is handled in the most efficient and compliant manner, with The Guild taking on full responsibility and liability for status and any other employment-related contractual enquiries.

Through a dedicated team of professionals, The Guild's approach is strengthened by more than 20 years' experience of employment compliance, status disputes, employment claims and Construction Industry Scheme operation.

Please feel free to contact us so that you and your clients can continue to dedicate your resources to what you do best.

Get in touch

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