



The VAT domestic reverse charge for construction services

From 1 October 2019 there will be a significant change to how suppliers in the construction industry supply chain account for VAT. The changes will apply to businesses making or receiving specified services that are reported under the Construction Industry Scheme (CIS).

Why the Change?

The change in legislation is an anti-fraud measure designed to counter “missing trader” fraud – a practice where parties in the construction supply chain charge VAT to customers and then ‘disappear’ without remitting the VAT collected to HMRC. HMRC estimate that the losses in unpaid VAT from the construction industry is around £100m per annum and have introduced similar fraud-prevention measures in respect of supplies of mobile phones and wholesale gas and electricity in recent years with significant success.

What is a Reverse Charge?

The reverse charge does not change the VAT liability, but instead changes the way in which VAT is accounted for. A reverse charge effectively shifts the VAT accounting obligations in respect of a supply from the supplier (as is conventional in most circumstances) to the recipient, who must

account for output VAT on the supply received and, simultaneously, recover some or all of this to the extent allowed. In the case of a business which is entitled to recover all the VAT it is charged, the reverse charge mechanism should not create a VAT cost, however there are many other considerations that the new measures create for businesses, which are explored briefly below. This is particularly pressing given that the introduction of the domestic reverse charge coincides with the new obligations established by Making Tax Digital for VAT.

When does the Reverse Charge Apply?

In general terms, every supply in a supply chain, except those to its “end user” will be subject to the reverse charge where the supplies utilised involve work to the fabric of a building; including site preparation, demolition and clearance, new build work, alterations, repairs, installing means of light, heat and power and clean-up works following developments (together: “specified services”). Any goods supplied with these services will also be subject to the reverse charge, however supplies of (for example) architectural services, the delivery of materials and so on will not.

End Users in a Supply Chain

Supplies to the 'end user' in a supply chain will not be subject to the reverse charge and will instead be subject to VAT at the appropriate rate. An 'end user' is a recipient of specified construction services who uses those services for any purpose other than making further supplies of specified services (i.e. subcontracting), and who would include, for example, someone receiving services to their own premises or a developer whose supplies are of completed properties rather than of construction services. End users must provide a declaration to their suppliers which clearly states their position as such and permits the charging of VAT, without which the reverse charge applies. This change is unusual in the VAT process, as in other situations such certification is usually to avoid being charged VAT, not to ensure it.

The new rules do not apply to contractors dealing directly with non-VAT registered customers and for contracts that are zero rated such as building new dwellings.

Impact on Businesses

These changes (amongst others) will require construction businesses to:

- Review each customer, supplier and contract to determine the appropriate VAT treatment and their place in the supply chain;
- Assess which sub-contractors may be adversely affected by these changes from a cash-flow perspective (as many use VAT charged to fund working capital before paying it to HMRC) and determine if payment processes need to be amended to prevent sub-contractors struggling and projects suffering;
- Amend invoicing procedures to ensure supplies subject to the reverse charge

are being invoiced correctly and with the correct narrative;

- Update accounting codes and the associated VAT treatment to correctly reflect transactions subject to the reverse charge and to feed information into the correct VAT return Box(es);
- Make appropriate amends to template legal documents to include reference to customer obligations around determining whether they are an "end user" for the purposes of the reverse charge;
- Upskill the relevant teams in accounts payable, receivable and procurement as to the changes and their roles in ensuring organisations are compliant;
- Introduce new review procedures to ensure all reverse charge obligations are being fulfilled and VAT returns are being submitted correctly.

Time to Take Action

With HMRC confirming that they will penalise non-compliance, it is crucial that any businesses who think they will be affected by these changes act now and ensure they understand the impact they will have and the obligations they create. We are happy to speak to all affected businesses in order to advise on specific circumstances and to provide bespoke guidance.

Armstrong Watson has a dedicated VAT team with a combination of Big4 practice, HMRC and in-house backgrounds, making us ideally placed to advise on the impact of the changes in a holistic way.

For a discussion on any of the above or for further information, please contact Alex Nicholson, Emma Forrester, or Stephen Ferrie on 0808 144 5575 or email help@armstrongwatson.co.uk.

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