

CLIVE OWEN LLP

VAT - Domestic Reverse Charge in the Construction Industry

CONSTRUCTION SERVICES DOMESTIC REVERSE CHARGE (CSDRC)

The CSDRC will apply to VAT registered businesses which supply certain services to other VAT registered businesses, but only where the recipient business then makes an onward supply of the same construction services. The supplier will be required to issue a VAT invoice stating that the services are subject to the CSDRC.

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What are the key points?

The CSDRC is being implemented to remove any risk that there may be an amount deducted, which is disguised as input tax, but which has never been paid over as output tax.



- With effect from 1 October 2019, a person supplying construction industry services to a VAT-registered customer will not account for VAT. The VAT registered customer will account for VAT under a “reverse charge” arrangement. That is, the customer will account for VAT as if he had made the supply to himself and will also, where applicable, recover the VAT.
- The services to which the CSDRC applies are the same as those to which the Income Tax Construction Industry Scheme (“CIS”) applies. The CSDRC also extends to any goods or materials supplied in conjunction with “construction services”.
- The CSDRC applies to supplies which would otherwise be subject to VAT at the standard or reduced rate. It does not apply to supplies made by someone who is not registered for VAT and it does not apply to zero-rated supplies.
- The CSDRC applies only to services that are made to a contractor: it does not apply to an “end-user” customer. However, there may be situations when this rule may be relaxed where both parties agree. Further guidance is due to be published by HMRC in the coming months which will shed light on this.

What does this mean for you?

For subcontractors the opportunity to use VAT to fund cashflow between the time it is received from the customer and the time it has to be paid over to HMRC will no longer exist. However, **contractors** will not suffer a delay between paying out VAT and recovering it, since both will now be dealt with on the same VAT return.

Construction services may be charged VAT at different rates dependent upon the work being undertaken i.e. 20% / 5% / 0%. The onus will now be on the contractor to verify the correct rate to be used for the reverse charge or if is to be used at all.

Before agreeing not to charge VAT on a taxable supply, a supplier of "construction services" will need to be satisfied that the supply falls within the CSDRC and, in particular, that the customer is a VAT-registered contractor not an end-user. It remains to be seen what steps a supplier will be expected to take to verify this or what the position will be should they get it wrong.

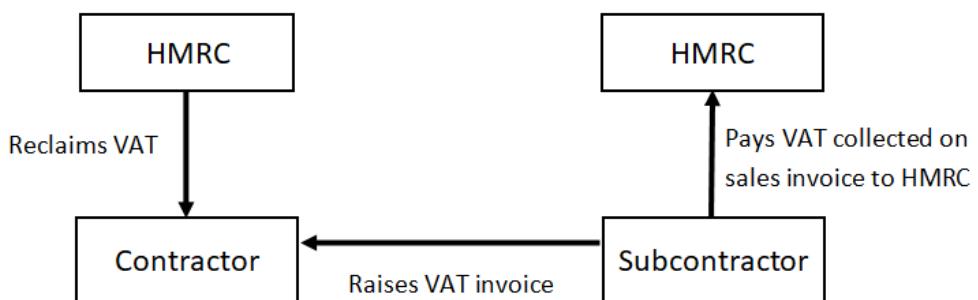
HMRC will be clarifying the following in the coming months regarding:

- The treatment for construction works which may have been supplied or contracted for before 1 October 2019, but paid for afterwards
- What happens if a customer either ceases to be, or becomes, an end user during a contract.

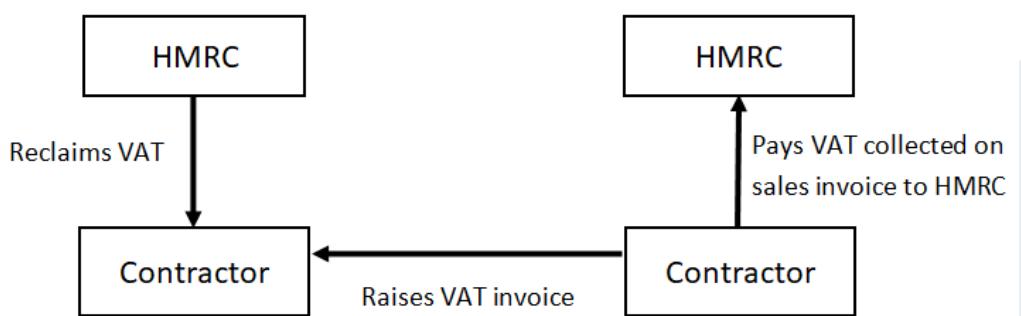


Diagrams - Existing procedure

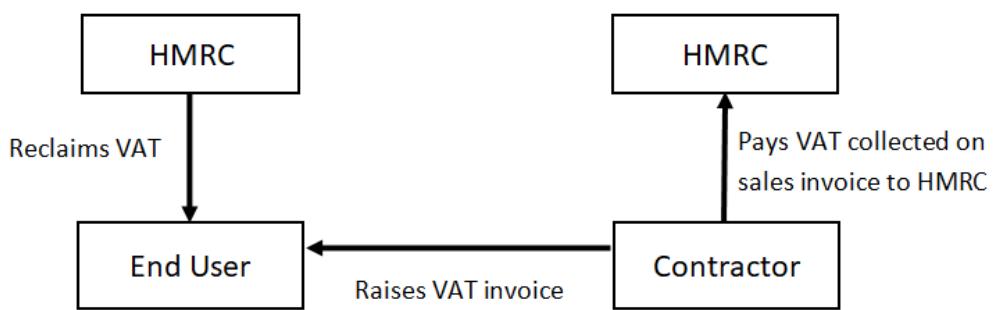
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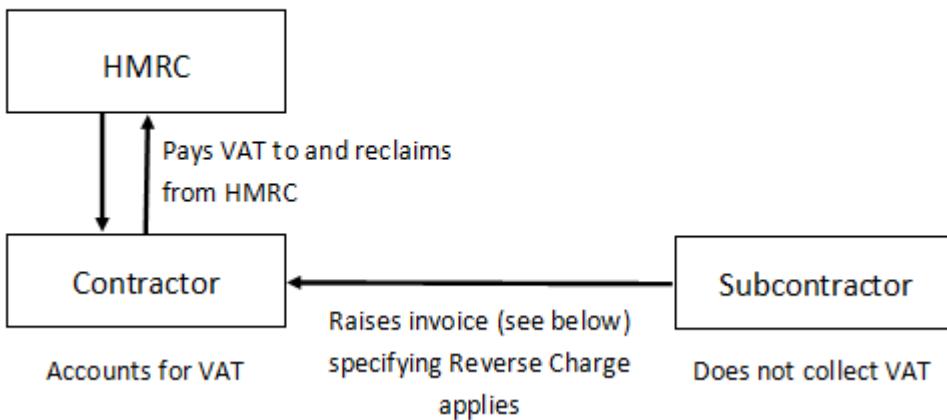


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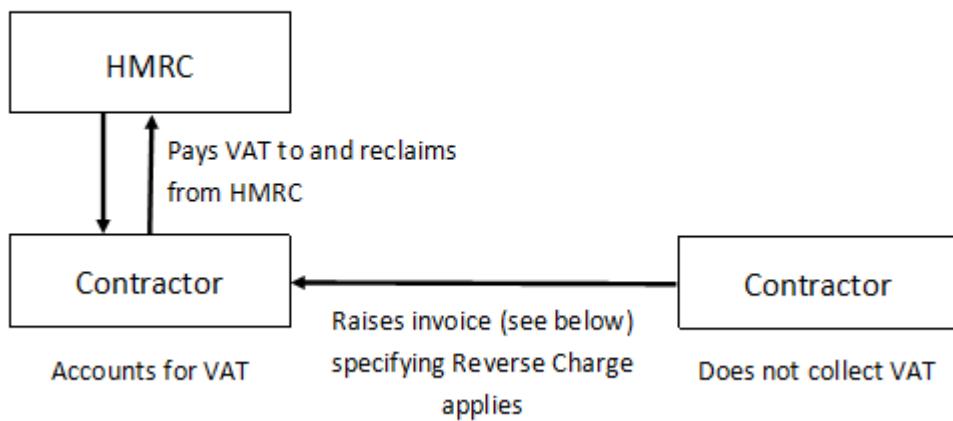


Procedure from 1 October 2019

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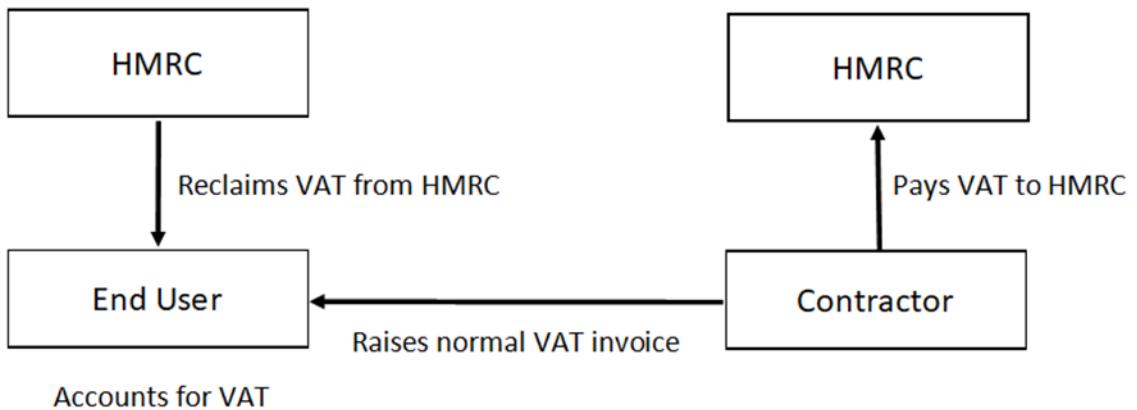


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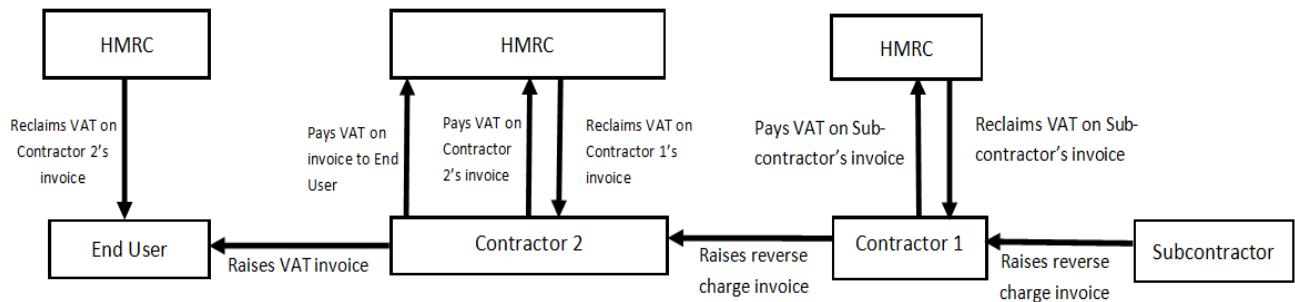


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Paper Invoices



Under EU law and the VAT Regulations 1995, invoices for reverse charge supplies, must include the reference 'reverse charge'. Examples include:

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

When making a relevant sale the invoice must show all the information normally required to be shown on a VAT invoice and must also include a reference that the reverse charge applies and the onus is on the customer to account for the VAT.

Unless otherwise agreed with HMRC, the amount of VAT to be accounted for under the reverse charge should be clearly stated on the invoice but should not be included in the amount shown as total VAT charged.

If you produce invoices using an IT system, and the system cannot show the amount to be accounted for under the reverse charge, then the wording should state that VAT is to be accounted for by your customer at the standard rate of VAT, based on the VAT-exclusive selling price for the reverse charge goods or services.

Suggested wording is: 'customer to account to HMRC for the reverse charge output tax on the VAT-exclusive price of items marked reverse charge'.

Procedure

Instead of paying VAT to the supplier, the customer becomes liable to account on its VAT return for VAT at the appropriate rate on the supply. The customer may recover that VAT amount as input tax, subject to the normal rules. Where the customer is a fully taxable business as will usually be the case, this would result in a nil net tax position with no VAT being due to HMRC; but, crucially, the risk that HMRC will give credit for VAT that they have never actually received is removed.

The CSDRC will apply to VAT registered businesses which supply certain services to other VAT registered businesses, but only where the recipient business then makes an onward supply of the same construction services. The supplier will be required to issue a VAT invoice stating that the services are subject to the CSDRC.

What are Construction Services?

- Construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations
- Construction, alteration, repair, extension or demolition of any works forming, or to form, part of the land, including (in particular) walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipe-lines, reservoirs, water-mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence
- Installation in any building or structure of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection
- 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 internal or external surfaces of any building or structure
- Services which form an integral part of, or are preparatory to, or are for rendering complete, the services described in this section, 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.

Which supplies are not included?

- Drilling for, or extraction of, oil or natural gas
- Extraction (whether by underground or surface working) of minerals and tunnelling or boring, or construction of underground works, for this purpose
- Manufacture of building or engineering components or equipment, materials, plant or machinery, or delivery of any of these things to site
- Manufacture of components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or delivery of any of these things to site
- The professional work of architects or surveyors, or of consultants in building, engineering, interior or exterior decoration or in the laying-out of landscape
- The making, installation and repair of artistic works, being sculptures, murals and other works which are wholly artistic in nature
- Signwriting and erecting, installing and repairing signboards and advertisements
- The installation of seating, blinds and shutters
- The installation of security systems, including burglar alarms, closed circuit television and public address systems.



There is a *de minimis* limit applicable to sales made for some reverse charge items, meaning VAT is charged as normal under a specified amount. We are waiting confirmation from HMRC that the *de minimis* applies to CSDRC supplies. Likewise, with regard to whether or not the first £1,000 of CSDRC purchases per month (whether combined with other items listed in VAT notice 735) can be disregarded for the purpose of assessing if a business has breached the VAT registration threshold.

Additional points

Certain additional points of interest have arisen from recently published HMRC guidance.

These include:

Materials in the ‘Labour only’ services

It is intended that it will cover the provision of construction services that includes materials and will therefore catch many more businesses than initially thought.

The legislation is designed so that if there is a “reverse charge” element in a mixed supply then the whole supply will be subject to the CSDRC. This is to make it simpler for both the supplier and customer, and to avoid the need to apportion or split out the supply.



Registration limit

Ordinarily, where a business receives “reverse chargeable” services, these are considered when looking at the VAT registration limit. However, the legislation update confirms that the value of supplies within the CSDRC scheme does not count towards the VAT registration threshold for the customer. This is good news especially for smaller businesses which are trading just below the £85,000 limit.

‘End user’

The CSDRC applies only to services which are required to be included in a return of payments under the CIS. These returns are made mainly by contractors, but also extend to “deemed contractors”—businesses that are not contractors, but which spend more than £1m a year on construction operations. However, the CSDRC excludes “end users” which are defined as businesses buying construction services for their own use rather than to sell on: therefore supplies made to CIS “deemed contractors” will usually be outside the scope of the CSDRC.

'CIS' status

It will be important both for suppliers and customers to be aware of their responsibilities under the CSDRC. Suppliers will need to be confident, before agreeing not to charge VAT, that a customer is in fact a contractor and not an "end user". Customers will need to ensure that a supplier does not incorrectly charge VAT on supplies that ought to fall within the scheme, for such VAT will not be recoverable as input tax. In each case, robust systems will need to be in place to give the necessary confirmations.

How will HMRC be enforcing the CSDRC?

In the first six months following implementation, HMRC will apply a light touch in dealing with errors, where businesses are genuinely trying to comply with the new legislation. However, where businesses knowingly fail to account for the reverse charge when it should have been due, penalties may be due.

CONTACT US:

Rosemary Anderson, Tax Partner

Oak Tree House, Harwood Road, Northminster Business Park,
Upper Poppleton, York YO26 6QU

01904 784400

york@cliveowen.com

www.cliveowen.com



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