



Construction Sector: Reverse Charge VAT

A guide for clients

The effects on supply chains from 1 March 2021.

Those working in the UK's construction industry will have to handle and pay VAT differently from 1 March 2021, unless there's another last-minute Government U-turn.

This is when the VAT domestic reverse charge for building and construction services, to use its full name, will finally take effect at the third time of asking. In this article, we'll refer to it simply as the 'reverse charge'.

The reverse charge affects VAT-registered businesses that operate under the construction industry scheme (CIS). These are usually tradespeople who either take on contracts or subcontract others within a typical supply chain.

The reverse charge was originally due to kick in from 1 October 2019, but that was put on hold for 12 months to give businesses more time to prepare for the UK's exit from the EU.

Then, on 5 June 2020, after many construction sites in England downed tools during the first national lockdown in April 2020, the introduction date of the reverse charge was put back by another five months – from 1 October 2020 to 1 March 2021.

Speaking at the time, a HMRC spokesperson said extending the deadline would “help businesses overcome the effects that the pandemic has had on them and give them more time to prepare”.

If you're VAT-registered and work in the construction industry, the new rules are complex and will change how you account for VAT. As a result, you might need to change how you present information on your invoices to your customers and how you prepare your VAT returns. If you are not VAT-registered you may find that you now need to register for VAT.

What is the reverse charge?

The reverse charge puts the onus on the customer who receives a construction service to account for the supplier's output VAT and to pay this output VAT to HMRC, instead of to the supplier.

It intends to reduce cases of VAT fraud that have been reported in the building sector, where suppliers have charged their customers for VAT but kept the money for themselves.

The charge applies to specified services made by businesses to other businesses that are reported under the CIS, while the customer will be able to recover VAT subject to the normal rules. Not all construction services will fall within the new rules.

Contractors & the reverse charge

From 1 March 2021, contractors should receive reverse charge VAT invoices for the CIS-regulated construction services they purchase, which are covered by the new rules.

Any VAT due needs to be directly accounted for on their next return, instead of paying VAT on CIS-related supplies on payment of the supplier's invoice.

This might provide a cashflow boost because the VAT previously paid when paying a subcontractor is 'netted off' in your VAT return instead, rather than being physically paid.

Subcontractors & the reverse charge

From 1 March 2021, subcontractors will be notified by the contractor where the reverse charge applies.

Where the reverse charge does apply, they will need to include all the information that is normally required on a VAT invoice, except no VAT will be charged.

Instead, the invoice should state that the reverse charge applies and the amount of VAT the customer is required to account for under the reverse charge.

It may also impact on their cashflow because the VAT previously paid with the invoice and held before paying the monthly or quarterly VAT bill to HMRC will no longer be received.

VAT in the construction sector

Three rates within the UK's VAT regime are applied on the sales of goods or services. In 2020/21, these are the standard rate (20%), the reduced rate (5%) and the zero rate (0%).

The new rules around the reverse charge apply to the standard rate VAT or reduced-rate construction services provided by VAT-registered businesses in the UK, but not to zero-rated supplies of services.

Examples of zero-rated supplies of construction services include building new residential accommodation or carrying out work within the homes of disabled people.

Installations of energy-saving equipment for over-60s, house conversions, and renovations are typical examples that might fall into the reduced-rate bracket.

VAT for most work on houses and flats by builders and similar tradespeople, such as plumbers, plasterers and carpenters, is charged at the standard rate, although some exceptions apply.

Normal VAT rules will apply where end-customers don't make an onward supply of construction services.

Where invoices have CIS and non-CIS registered supplies and the reverse charge applies, it will apply to the whole invoice.

How are the rules applied?

The following example best demonstrates how the rules will be applied in practice from 1 March 2021. Both fictional parties are VAT-registered and operating under the CIS.

Tom owns a property development firm. He hires Sam to manage the conversion of an old office block into residential flats. Rich is an electrician who accepts a contract from Sam for his business to install all of the electrics in the building.

Rich (the subcontractor) is supplying a service to Sam (the contractor), who is supplying a construction service to Tom.

If Rich was to invoice Sam before 1 March 2021 for £120,000, which includes all materials, labour and works (£100,000), he would include VAT at 20% (£20,000), which would be paid over to HMRC on his next vat return.

He would receive £120,000 in payment and have £20,000 at his disposal to support his business's cashflow until his next VAT return liability is due. Sam would claim £20,000 input VAT on his next VAT return.

But if Rich was to invoice Sam on or after 1 March 2021, it would be for £100,000, he would state the CIS reverse charge applies and the applicable rate of VAT is 20%. Rich does not need to account for output VAT of £20,000, but neither does he have the cash available short-term to support his cashflow.

Sam would then pay Rich £100,000 and would need to account for both input and output VAT of £20,000 on the supply on his VAT return.

Under the reverse charge, Sam's cashflow position is boosted since he no longer has to pay the £20,000 input VAT over to Rich and then subsequently reclaim it on his next return.

What do you need to do to get ready?

If your business operates in the building and construction industry, you'll need to take the following steps to prepare if you haven't done so already:

- check whether the reverse charge affects any of your sales and/or purchases
- update your accounting software to ensure it can deal with the reverse charge
- assess the impact of the change on your cashflow
- make sure any staff who are responsible for VAT accounting know how to deal with the reverse charge.

If you're a contractor and you haven't already done this, review all of your contracts with subcontractors, work out whether the reverse charge will apply, and notify your suppliers if it will.

If you're a subcontractor who's only learning about this now, contact your customers to find out whether the reverse charge will apply.

HMRC previously said it "understands that implementing the reverse charge may cause some difficulties", and had promised to take a light-touch approach to any errors made in the first six months of the new legislation.

Those errors will need to be corrected as soon as possible, however, and you need to show that you were trying to comply with the rules and that you have "acted in good faith".

We can talk you through the way the reverse charge works, and what you need to do ahead of the new implementation date.

Get in touch to discuss accounting for VAT.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

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