

## Domestic Reverse Charge VAT for the Construction Industry

### Introduction

The current Construction Industry Scheme (CIS) was launched in 1999 to combat income tax evasion within the construction industry. Similar schemes existed prior to this. The scheme aims to deduct tax at the point of supply to reduce the risk of the subcontractor becoming a 'missing trader' and not paying the tax over to HMRC.

From 1 October 2019, HMRC are bringing in new rules to try and reduce the risk of the same missing trader fraud for VAT in the construction industry.

The rules are referred to as the 'domestic reverse charge' in order to differentiate it from the reverse charge rules applicable to supplies from the EU.

The rules only apply to specified services by a subcontractor to contractor. Which are described in detail below.

Specific issues, special schemes and potential side effects are also covered.

HMRC has its own guidance on the domestic reverse charge which can be found here - <https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services>

### Services included and excluded

#### Specified Services

Generally, a supply that is subject to CIS will be subject to the domestic reverse charge as long as the supply is not made to the 'End User'. The 'End User' is the term used in legislation to describe a consumer or business that does not make an onward supply of the service in question.

The domestic reverse charge will not apply to supplies which are zero rated or exempt from VAT or if the customer is not registered for VAT in the UK.

These services include:

- constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services
- constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours
- pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence

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- installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure
- 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 inside or the external surfaces of any building or structure
- services which form an integral part of, or are part of the preparation or completion of the services described above - 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

#### *Excluded Services*

Some specific services are excluded, and these are:

- drilling for, or extracting, oil or natural gas
- extracting minerals (using underground or surface working) and tunnelling, boring, or construction of underground works, for this purpose
- manufacturing building or engineering components or equipment, materials, plant or machinery, or delivering any of these to site
- manufacturing components for heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems, or delivering any of these to site
- the professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants
- making, installing and repairing art works such as sculptures, murals and other items that are purely artistic
- signwriting and erecting, installing and repairing signboards and advertisements
- installing seating, blinds and shutters
- installing security systems, including burglar alarms, closed circuit television and public-address systems

#### *Mixed Supplies*

One significant difference to the CIS rules is that if the supply is a mixture supplies, labour and materials for example, then as long as some of the supplies are subject to the domestic reverse charge then all other supplies will also be subject even if they are only a minor part of the overall supply.

#### *Voluntarily applying the Domestic Reverse Charge*

If a supply has been made between two parties and this was subject to the domestic reverse charge then both those parties, jointly, can agree to treat all future construction supplies as domestic reverse charge supplies.

#### *Employment businesses supplying construction workers*

It is not anticipated that the supply of workers by an employment business will be subject to the domestic reverse charge. This is because the employment business is deemed to be making a supply of staff if the workers are paid by the employment business rather than the construction business which uses them.

It is likely that this issue will give rise to questions such as whether a personal service company supplying the director is a supplying staff or construction services. HMRC VAT Notice 700/34 gives more guidance on this.

#### *Potential Complications*

One of the most common CIS errors is failing to determine and understand whether a specific construction service falls within the scheme or not. As the domestic reverse charge rules generally mirror these then it is likely that people will have the same difficulties.

We would suggest that you regularly refresh yourself on the rules of CIS. More guidance can be found here - <https://www.gov.uk/hmrc-internal-manuals/construction-industry-scheme-reform/cisr14000>).

### Raising Invoices under the domestic reverse charge

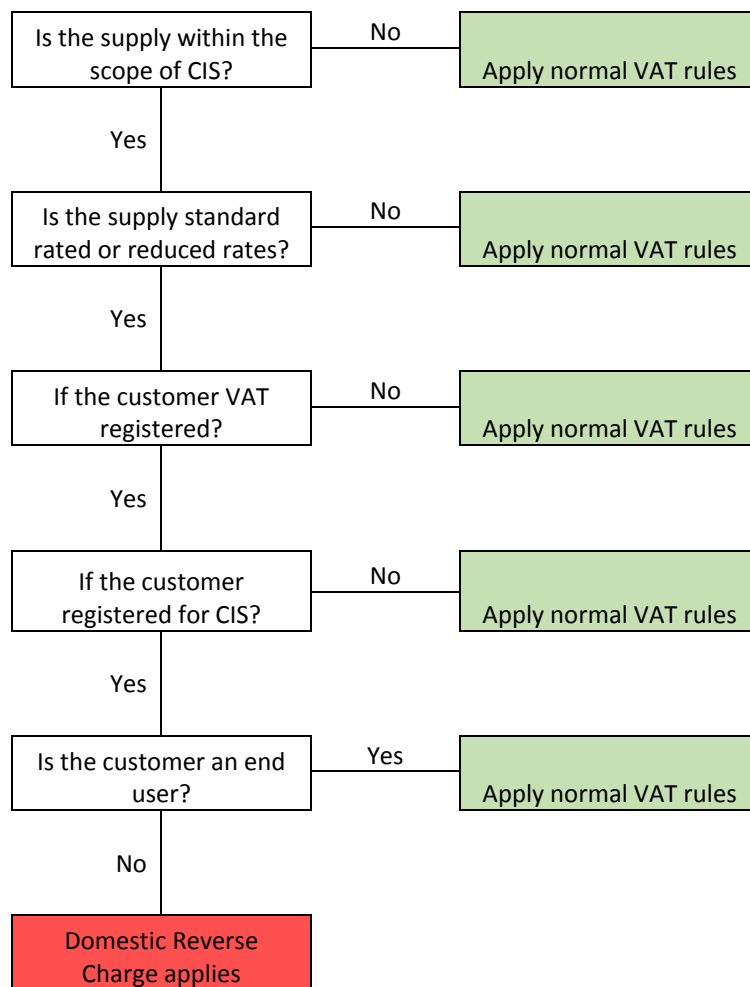
*Check the customer is VAT registered*

The reverse charge should only be applied when the supplier is satisfied that the customer is VAT registered. Obtaining and validating the customers VAT number is recommended - [http://ec.europa.eu/taxation\\_customs/vies/](http://ec.europa.eu/taxation_customs/vies/).

*Check the customer is registered for CIS*

If the customer is making an onward supply of specified construction services, then they should have a CIS registration. The following flow chart shows that if the customer is not registered for CIS then VAT should be charged as normal. HMRC have confirmed that their CIS verification system can be used and although this system will ask the user to confirm that they have placed an order with a subcontractor, for VAT purposes it is acceptable to say yes even when it hasn't!

*Flowchart to decide whether to apply the domestic reverse charge*



### *Details on Invoice*

To comply with the VAT regulations, any invoice for a supply that is subject to the domestic reverse charge must:

- Not charge VAT; and
- State that the supply is subject to the reverse charge
- Show the amount of VAT due under the reverse charge. If this is not possible then the rate of VAT must be shown. This must be in the form of a note and not included in the amount charged to the customer.

### *How to complete the suppliers VAT return.*

If you are supplying services, then you simply need to enter the net amount of the service in box 6 of the return and nothing into box 1. This has no bearing on any input VAT you can reclaim in respect of making those supplies.

One consequence of this are that many suppliers are likely to now become repayment traders. This is a term used to describe traders who regularly receive repayments of VAT from HMRC.

### *Making Tax Digital*

Software packages are likely to include a specific tax code for supplies under the domestic reverse charge. However, if you are using bridging software or excel then we suggest that invoices are recorded on the system showing VAT at the applicable rate and then an adjustment made to Box 1 prior to submission.

### **Receiving Invoices under the domestic reverse charge**

When you receive an invoice from a supplier, you should also consider the VAT treatment and decide if their treatment is correct. Please note that the supplier should have checked this prior to sending the invoice but it is likely that it will take time for people to understand and apply these rules correctly.

If the reverse charge has not been applied but it should have been then you are still liable to be assessed for the VAT. This means that you could end up paying additional VAT yourself and then having the challenging task of trying to get a correct invoice and refund of payment from the supplier.

### *Contracts spanning 1 October 2019*

Customers will have to review contracts before 1 October 2019 to determine which ones will be subject to the domestic reverse charge.

In addition, it is important to regularly review contracts as it is possible that a customer may change from an end-user (no reverse charge) to a contractor (reverse charge) or vice versa during a contract.

### *How to complete the customers VAT return.*

The customer of a reverse charge invoice should enter the output tax in Box 1 but no corresponding net figure should be entered in Box 6.

The customer should then enter the net amount of the supply in Box 7 and VAT in Box 4 as usual.

The net VAT due based on these entries will be zero.

Although the net amount is not included in Box 6, it is important to keep a record of this as it will form part of the customers taxable turnover for VAT registration and de-registration purposes. In practice this may mean that a construction business has a lower effective VAT registration and de-registration point.

### Example 1.1:

Paul is a brick layer and is VAT registered. Paul invoices Kate who is also VAT registered and uses many brick layers as part of a construction project. Paul correctly invoices Kate for £1,000 and states on the invoice that there is £200 of VAT on this invoice subject to the domestic reverse charge. The following entries are put on Paul and Kate's VAT returns.

	<i>Paul</i>	<i>Kate</i>
<i>Box 1</i>		200.00
<i>Box 2</i>		
<i>Box 3</i>	0.00	200.00
<i>Box 4</i>		200.00
<b><i>Box 5</i></b>	<b>0.00</b>	<b>0.00</b>
<i>Box 6</i>	1,000.00	
<i>Box 7</i>		1,000.00

### Example 1.2:

Following on from the above example lets now assume Kate invoices Dave who is the end user. The total of her invoice is £5,000 but she must charge £1,000 of VAT as normal. The domestic reverse charge does not apply to this transaction as Dave is an end user. Kates VAT return will now look like the below:

	<i>Kate</i>
<i>Box 1</i>	1,200.00
<i>Box 2</i>	
<i>Box 3</i>	1,200.00
<i>Box 4</i>	200.00
<b><i>Box 5</i></b>	<b>1,000.00</b>
<i>Box 6</i>	5,000.00
<i>Box 7</i>	1,000.00

## Specific Issues

### *Self-Billing*

If you currently 'self-bill' then if the date you enter the information into the customers system is before 1 October 2019 and the payment is received before 31 December 2019, you can use the old rules. If either of these dates are missed, then you will have to apply the domestic reverse charge.

### *Continuous Supplies*

Providing building services can often be seen as a continuous supply for VAT purposes. The 1 October 2019 date is relevant for the tax point of the service. During a continuous supply this is normally the VAT invoice date or the payment date (whichever is earlier).

### *Single Supplies*

For one-off contracts the tax point is when the supply is performed. This specific point can be 'over-written' by an actual tax point which is the earlier of the receipt of payment or the invoice date (provided it is raised within 14 days of the service)

### *Cash Accounting for VAT*

If you currently use the cash accounting scheme, then you can continue to use it BUT any supplies subject to the domestic reverse charge must be excluded and accounted for under the normal VAT rules.

### *Flat Rate Scheme*

Any supplies under the domestic reverse charge scheme can be ignored if you use the flat rate scheme.

### *Credit Notes*

If a credit note is raised in the normal course of business and both the supplier and customer agree, then the original invoice does not need to be adjusted. If not, then the supplier should issue a credit note applying the principles of the domestic reverse charge. A recommended note to add would be 'UK customer to account to HMRC for the adjustment to reverse charge output tax on the VAT exclusive prices marked reverse charge.'

### *Cash-Flow*

Subcontractors may suffer a negative cash flow impact because of these changes. They will no longer receive the payment of VAT from customers but will still have to pay the VAT on their supplies. It is recommended that if this is of concern and they are likely to become a repayment trader, then they can register to file monthly VAT returns in order for them to get these repayments sooner.

### *VAT Registration Point*

The current VAT registration threshold is £85,000. The legislation states that supplies which are subject to the reverse charge form part of your taxable supplies in this regard.

Therefore, to work out your current taxable turnover you will need to include any supplies subject to the domestic reverse charge even though it was not your supply.

Let's assume Laura is a contractor with a current turnover of £80,000 and has not voluntarily registered for VAT. During the last month Laura has used Mike to assist her. Mike is VAT registered and carried out some specified services for her. She received an invoice from Mike for £8,000 + VAT of £1,600. The domestic reverse charge does not apply to this invoice as Laura is not VAT registered.

However, Laura's taxable turnover for VAT now needs to include this £8,000 even though she wouldn't have to include it in Box 6 of her VAT return (or in her accounts). As her turnover is now deemed to be £88,000 she must register for VAT.

She must also let Mike know that she has registered so that any future invoices from him are subject to the reverse charge.

### **Penalties**

HMRC have said that their officers will operate a 'light touch' approach for the first 6 months after 1 October 2019. This is on the assumption that the customer has acted in good faith and is trying to comply with the legislation. Officers may still hand out penalties during this period if they believe the customer has deliberately taken advantage of the rules.

In addition, they have stated that if the supplier has applied the reverse charge but has been misled by the customer then the supplier will not be required to account for output tax on the sale.

If the supplier has not taken sufficient steps to check the credentials of the customer, then they may be assessed for the output tax.

If the supplier incorrectly charges VAT, then the customer will still be assessed for the output tax. The supplier should then reimburse the VAT paid by the customer.