



## **Guide to Construction Industry Scheme VAT Reverse Charge**

In an attempt to stop fraud in the construction industry, HMRC will be introducing a domestic reverse charge which will take effect from 1st March 2021. The new legislation will only apply to certain building and construction services. It will mean that the customer will now be liable to account for the VAT on purchases, rather than the supplier, just as it currently works when dealing with businesses within the EU.

### **1. What is the Construction Industry VAT Reverse Charge?**

The charge will be introduced in a new effort by the government to combat missing trader fraud. Missing trader fraud occurs when fraudsters set up, operate as normal but siphon off VAT as it moves up the supply chain. They will normally operate for six - nine months before closing the business and vanishing without paying HMRC any of the tax.

The new reverse charge taxation system will mean that VAT cash will no longer flow between businesses. For every transaction that is made, the VAT will be registered and clearly stated on the invoice as a reverse charge. Rather than the supplier charging, collecting and accounting for the VAT, it is the customer who receives the supplies who accounts for the VAT.

### **2. Who will the Construction Industry VAT Reverse Charge Affect?**

The VAT reverse charge will affect everyone who is VAT registered that invoices customers under the current CIS scheme, when those customers are not the end user. An end user is described as a homeowner, or a business that sells new complete homes.

### **3. How will the Construction Industry VAT Reverse Charge Work?**

When invoicing a customer, suppliers will now have to identify if the customer is an end user. If they are, the supplier invoices them plus VAT as per normal.

If the customer is not the end user – i.e. they are completing construction work for a house owner or another business – then the supplier must raise an invoice to them without VAT. The invoice needs to state that VAT must be accounted for by the customer "Under the Reverse Charge"

The customer would then need to add VAT to the bill from the supplier in their books as Output VAT i.e. increasing their sales, then reclaim it as input VAT i.e. increasing their expenses. This would give a net VAT result to them of zero.

The supplier can reclaim the VAT from their expenses as normal – materials etc, as per usual, but will not have to include this sales VAT on their VAT return, or pay it over to the HMRC. Smaller businesses who are reliant on VAT income moving up the supply chain may suffer financially as a result of the reverse charge.

In other words, those that are used to getting the work charged plus 20% paid into their bank, will now only get the work charged. If they complete a lot of reverse charge work, and still claim the cost of all of their expenses, this could result in VAT refunds – but these will only be paid over quarterly. They therefore may need to prepare for potential cashflow problems once the reverse charge is introduced.

### **Working Example 1:**

Jon is a VAT registered plumber and works for a homeowner Sansa. He refits a new bathroom for her in her house for £1000. Materials are £500.

As she is the end user, he charges VAT on his invoice - £1000 + VAT £200 = £1200. She repays the whole of the invoice, and he puts the “output VAT” of £200 into Box 1 on his VAT return.

He puts his “input VAT” of £100 into Box 4.

He then pays the net of his input and output VAT (Box 1 less Box 4 - £100) over to the HMRC at the end of the quarter.

### **Working Example 2:**

Jon also completes some plumbing work for Arya, a builder who is renovating a palace for Tyrion. Jon installs a new toilet into the palace for £400. Materials cost him £200.

As Arya is not the end user, Jon sends her an invoice for £400 without VAT on it – but with the statement “VAT to be accounted for by the customer under the Reverse Charge”.

She pays the net invoice of £400, and he does not add any VAT to the “Output VAT” into Box 1 on his VAT return for this work.

He can still reclaim the input VAT on any materials he has purchased for the job – in this case £40.

He then pays the difference of his input and output VAT (Box 1 less Box 4) over to the HMRC at the end of the quarter.

If he has completed the majority of his work in the quarter at the palace for Arya, it is likely his reclaims will be higher than the VAT he owes, and he will get a refund i.e. in this case he will receive back £40.

Arya, when accounting for Jon's invoice, adds the VAT he should have charged her of £80 into her Box 1 on her VAT return.

She then claims back the whole of the VAT of £80 in Box 4. The net result on her VAT return for these two transactions is therefore £0.

Due to this new system, Arya has not paid over any money to Jon for VAT, so he is unable to leave and join the Night's Watch again, taking the HMRC's tax money with him.

#### **4. What Specific Construction Services does the Construction Industry Reverse Charge Apply To?**

The reverse charge only applies to supplies of specified construction services to other businesses in the construction sector. Below are a few examples but this list is not exhaustive:

- Painting or decorating the external or internal surface of any structure or building.
- Installation of heating systems, air-conditioning, lighting, power supply, drainage, ventilation, water supply, sanitation and fire protection in any structure or building.
- Construction, repair, extension, alteration, demolition and dismantling of structures or buildings (including offshore installations) whether they are permanent or not.

Supplies that are excluded

- Professional work of surveyors, architects or consultants in the building.
- Machinery and the delivery of the machinery to the site.
- Drilling for the extraction of natural gas or oil.
- Installation of security systems which include closed-circuit television and burglar alarms.

#### **5. Further Information**

This information was accurate as of February 2021. The HMRC have still to finalise the new rules and their timescales. If you need any help with this new procedure please contact us and we would be happy to help.

Please get in touch for a no obligation chat.