A fresh look for construction

Indirect Tax OMB



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Neil Warren considers the new reverse charge rules for the construction industry and the practical VAT issues that will be relevant to builders who trade with other builders from 1 March 2021

Key Points

What is the issue?

Major VAT changes will take place on 1 March 2021 that will affect all VAT registered builders who work for construction industry clients. It is important that accounting

procedures are adapted and that staff are clear about when the reverse charge will and will not apply.

What does it mean for me?

If a builder fails to charge VAT on a sales invoice because he incorrectly thought the reverse charge applied, or a building business buying services incorrectly pays VAT to a supplier when the reverse charge should have been applied, HMRC will have the power to raise assessments to correct the errors made.

What can I take away?

There is a clause in the latest legislation concerning a ‘5% disregard’ when the reverse charge will not apply. This article considers what this means and how it will work in practice.

It will be a case of third time lucky when the new reverse charge rules for the construction industry are finally introduced on 1 March 2021. As many readers will know, previous introduction dates of 1 October 2019 and the same date in 2020 were delayed by HMRC for very good reasons, coronavirus being the reason for the second delay. In this article, I will focus on practical issues about how the rules will work in practice, including the new concept of a ‘5% disregard’.

Services covered by new rules

The reverse charge will only apply if the supplier and customer are both trading in the construction industry, and are both registered for VAT. A typical situation would be a subcontractor working for the main building contractor on a specific project. The customer must be registered for the Construction Industry Scheme (CIS) and the work in question must come within the scope of the CIS, e.g. decorating a room or laying bricks. The work must be subject to either 5% or 20% VAT.

However, the key condition is that the business receiving the supplies from the other builder must be making an onward supply of those services to another customer. ***See Plumber Pete: Reverse charge and plumbing services***, which also confirms the VAT return boxes that will be completed by both parties for a reverse charge deal.

Other important points are as follows:

- The reverse charge will extend to any materials supplied by the builder as part of his work.
- The customer receiving reverse charge invoices must use the invoice or payment date, whichever happens first.
- If builders supplying services use the flat rate scheme, reverse charge sales are completely excluded from the VAT return. In reality, it will be sensible in most cases for the builder to leave the scheme if reverse charge supplies are significant so he can claim input tax on his expenses.

End user and intermediary supplier Consider this question: following on from the example above, will all of Plumber Pete’s work for Main Contractor be subject to the new reverse charge rules? The answer is ‘no’ if Main Contractor is classed as either an ‘end user’ or ‘intermediary supplier’ for the services in question:

- **End user:** This would be relevant if the work being done by Pete is not relevant to an onward supply of construction services made by Main Contractor. For example, it might relate to building work carried out at its head office, or perhaps at a property it rents out to a tenant. In this situation, the onus is on Main Contractor to advise Pete that it is an ‘end user’ for this particular job. Pete will charge 20% VAT on his invoice in the same way.
- **Intermediary supplier:** This is a business that is registered for both CIS and VAT that is connected or linked to end users. The connection is based on Companies Act 2006 s 1161; i.e. the two entities are in the same corporate group or undertaking. A link exists if both the intermediary supplier and end user have a relevant interest in the same land where the building work is taking place, such as a landlord and tenant arrangement. So, even though the intermediary supplier is making an onward supply of construction services to the end user, the supplies it receives from other builders will be subject to normal VAT rules rather than the reverse charge.

Image

PLUMBER PETE: REVERSE CHARGE AND PLUMBING SERVICES

Plumber Pete is VAT registered and working as a subcontractor for a construction business called Main Contractor, which is building a new office for a firm of solicitors. Main Contractor is VAT and CIS registered. Pete issues an invoice for £10,000 on 1 April 2021 and does not charge VAT because the supply is subject to the new reverse charge rules that took effect on 1 March 2021:

- Pete will declare the sale in Box 6 of his VAT return; i.e. the outputs box.
- Main Construction will account for output tax of £2,000 in Box 1 of its return because the work is standard rated. It will claim the same amount as input tax in Box 4 – there is no input tax restriction for on this supply for partial exemption or non-business issues. The net value of £10,000 is included in Box 7 (inputs).

Customer responsibilities

The customer receiving building services must always notify the supplier in writing of an end user or intermediary supplier situation. A suggestion in the HMRC guidance is that the supplier should include a statement in the terms and conditions of a contract along the lines of: 'We will assume you are an end user or intermediary supplier unless you say you're not.' The builder supplying services is therefore adopting a cautious approach of charging VAT on all invoices unless the customer says otherwise. It is important that customers deal with this situation properly because if they are charged VAT on a 'reverse charge' supply, HMRC will have the power to assess output tax, leaving them with a double VAT hit. The customer must then ask the supplier for a VAT credit to balance the books again.

Invoice splitting

An accountant that I act for is very concerned that his builder clients will be badly affected by the adverse cash flow outcome of not collecting VAT from customers and keeping it in their bank accounts for up to three months before paying it to HMRC on a return; i.e. the loss of important working capital. This is relevant for many small builders. The accountant asked if a possible solution was for his clients to raise separate sales invoices for each job; namely, an invoice for the building materials (not subject to the reverse charge) and a separate invoice for labour (which would be subject to the reverse charge).

Unfortunately, this strategy will fail because the job is classed as a single supply of construction services with materials, and that outcome doesn't change by raising separate invoices. To quote from the HMRC guidance: 'If a customer places a single supply and fix order within the scope of the CIS with a supplier, the reverse charge will apply to the full value of the order even if the supplier issues separate invoices for the supply and fix elements.'

You might think that a possible solution is to raise two separate orders, one for materials and one for labour, but HMRC is ahead of the game here as well: ‘If the works are to be provided at the same time and on the same site … they comprise a single supply for VAT purposes.’

For details about sales invoices, see ***Information to be included on a reverse charge invoice.***

Employment business

The reverse charge rules do not apply to an employment business. This is because they are deemed to be supplying ‘staff’ rather than ‘construction services’. There have been many tribunal cases about whether a supply of services or staff is being made, particularly in the medical sector. However, the key issue is whether the builder being supplied to a construction business comes under the control and instruction of the agency or construction business.

If a construction business asks an agency for the services of, say, an electrician, with an hourly or daily rate being paid to the agency, this will almost certainly be a supply of staff. The construction business will tell the electrician what work to carry out, and it will monitor the quality of his output. There will be no comeback on the agency if, say, the electrician fits some wires the wrong way round.

The 5% disregard

A new concept has been added to the latest rules, which relates to the situation where only some of the work on an invoice is subject to the reverse charge but this amount is 5% or less than the total value of the invoice. The previous approach was that all of the invoice would be subject to the reverse charge, even if only £1 was relevant to reverse charge work. See Decorator Debbie: 5% disregard rule.

Image

INFORMATION TO BE INCLUDED ON A REVERSE CHARGE INVOICE

- The information is the same as for a normal sales invoice; i.e. the supplier's business name, address and VAT number, as well as the name and address of the customer. It should also include the VAT registration number of the customer.
- The invoice must make it clear that the reverse charge applies.
- The amount of VAT to be accounted for by the customer on their VAT returns should be clearly shown, either as a total figure of £X or the VAT rate that applies to the job. The latter approach is useful if an invoice includes work subject to different rates of VAT.
- Wording such as: 'Reverse charge – customer to pay the VAT to HMRC' should be prominently recorded on the invoice.

Note that some builders might use wording that quotes the VAT legislation; e.g. 'No VAT charged – Value Added Tax Act 1994 s 55A applies to this invoice'. This is fine but might confuse a purchase ledger clerk wondering what s 55A means.

DECORATOR DEBBIE: 5% DISREGARD RULE

Decorator Debbie has a contract with a construction industry client for two jobs. The first is to redecorate six rooms in the company's head office for a payment of £8,000. The client has confirmed it is an end user for this work. The second job is to decorate a room in a hotel, which relates to a contract being done by Debbie's client for a hotel chain for a payment of £400.

Debbie issues a single invoice for both jobs. The whole of the invoice would normally be subject to the reverse charge because it includes some reverse charge work; i.e. decorating the hotel. However, because the reverse charge work represents '5% or less' of the total invoice (£400 divided by £8,400 = 4.7%), normal VAT rules apply; i.e. Debbie charges £8,400 plus £1,680 VAT.