Combatting VAT fraud: options to tackle fraud on the provision of labour in the construction sector

Indirect Tax

01 May 2017

HMRC seeks views on proposals to prevent supply chain VAT fraud in the construction industry by using a domestic VAT reverse charge for labour services.

Announced at Spring Budget 2017, HMRC have published a call for evidence on ‘Fraud on provision of labour in construction sector: consultation on VAT and other policy options’. Whilst primarily seeking views on the viability of a VAT domestic reverse charge to combat fraud, the proposals also look at changing the rules around gross payment status within the Construction Industry Scheme.

What is the issue?

HMRC reports that organised fraud has largely involved civil engineering projects but has concerns that these arrangements could be found in any large construction project. They are aware of organised crime groups artificially extending the supply chains with the intention of failing to pay VAT and making incorrect income tax deductions.

HMRC considers the domestic reverse charge has been effective at tackling VAT fraud in the telecoms and energy sectors and now wishes to extend the regime to the construction sector.

What is a reverse charge?

The effect of a reverse charge is to ensure the supplier of goods or services is not involved in the payment of VAT to HMRC.

Instead, it is the purchaser of the goods or services that accounts for the VAT due to HMRC. The purchaser does this by declaring the VAT due as output tax on its VAT return. The same amount can typically be reclaimed as input tax on the same VAT return (subject to the normal rules for partial exemption etc). This means that for most transactions the VAT is simply netted off and is no more than an accounting entry.

What is our initial reaction?

We support HMRC taking action to combat fraud in this area. The reverse charge is a relatively simple concept with minimal administrative burden. It is an effective way of mitigating VAT losses.

However, as HMRC acknowledge, introducing the reverse charge to construction services would affect a wide range of suppliers and customers. There would also be different impacts depending on the type of customer (a private developer, public authority or voluntary organisation) because of the complexity of the rules around VAT and construction.

This would be the first time the reverse charge would be applied to an area dealing with different VAT liabilities with the potential for significant complexity. Projects may involve several different rates of VAT (e.g., a mixed residential, commercial and non-business community project funded by public authority and voluntary agencies). Determining how to define and apportion construction services across a multi-rate project (and identifying these elements on domestic invoices) would be challenging and perhaps adds weight to the view that VAT rules concerning property and construction need to be simplified.

Details to consider further

HMRC want views on what services might be covered by a reverse charge and whether it should apply to supplies to final customers. Also, whether there should be a threshold to exclude small businesses; perhaps applied to the value of the contract. Interactions with self-billing, payments on account and the flat rate scheme are also considered. Other options look at amending the Construction Industry Scheme definitions and other qualifying criteria.

HMRC will be arranging stakeholder meetings to explore these proposals. Please send any comments you have to us by Friday 19 May 2017.