



New domestic reverse charge rules for construction services - effective from 1 March 2021

15 January 2021

Introduction

After postponements in 2019 and 2020 due to coronavirus and industry concerns regarding its implementation, HMRC now intend to introduce the domestic reverse charge (DRC) for 'specified services' in building and construction services from 1 March 2021.

The new rules are designed to combat fraud within the industry by making the recipient of the supply liable to account for and reclaim the VAT on their VAT return (subject to the normal rules).

This is not a new procedure in the VAT world; there are already reverse charge rules for other areas that have been subject to fraud such as mobile phones.

Missing trader fraud

This removes the opportunity for missing trader fraud i.e. the supplier charging VAT and then disappearing with the VAT without declaring it. The long-established Construction Industry Scheme (CIS) already serves to counter evasion of income tax and national insurance in the sector and the reverse charge is a similar concept. It only applies if the customer is CIS-registered and if the payments are within the scope of the CIS i.e. specified services. The list of specified and excepted services are listed below.



Specified supplies

Where a VAT-registered business receives a supply of specified services (which are not excepted supplies) from another VAT-registered business on or after 1 March 2021, it accounts for that VAT amount through its VAT return instead of paying the VAT amount to its supplier. It will be able to reclaim that VAT amount as input tax, subject to the normal rules. The supplier will need to issue a VAT invoice that indicates the supplies are subject to the reverse charge, HMRC suggest “Reverse charge: S55A VATA 1994 applies” or “Reverse charge: customer to pay the VAT to HMRC”. The invoice should however state the rate of VAT to be accounted for, 5% or 20%.

It was originally intended that supplies by contractors to a final customer, such as an occupier, would automatically be outside the reverse charge, and so a main contractor would continue to charge VAT as before. An amendment to the law in June 2020 however requires end users and intermediary suppliers to notify their sub-contractors of their end user or intermediary supplier status in writing.

Default to the reverse charge

This means that the default is for the reverse charge to apply unless the supplier receives a statement from the customer.

The change is designed to make sure both parties are clear as to whether the supply is excluded from the reverse charge. It effectively gives the end user the choice of whether to apply the reverse charge or not and may be beneficial with regards to cash flow. HMRC’s guide offers the following as an example of suitable wording:

‘We are an end user for the purposes of section 55A VAT Act 1994 reverse charge for building and construction services. Please issue us with a normal VAT invoice, with VAT charged at the appropriate rate. We will not account for the reverse charge.’

It is important to note that the reverse charge will only apply where supplies are at the standard or reduced rate of VAT and the sub-contractors are registered for VAT.

Light touch

There may be some comfort in the guidance which states that;

‘HMRC understands that implementing the reverse charge may cause some difficulties and will apply a light touch in dealing with any errors made in the first 6 months of the new legislation, as long as you are trying to comply with the new legislation and have acted in good faith.’

... HMRC officers may assess for errors during the light touch period, but penalties will only be considered if you are deliberately taking advantage of the measure by not accounting for it correctly.’

Hopefully HMRC will follow through with this approach. It is worth noting that they do not suggest that the light touch applies to someone who is unaware of its introduction.

The reverse charge applies regardless of the value of the works: there is no de minimis threshold.

Exclusions

1. 5% disregard

Where the supply is mainly of goods, with only a minor element of services, and those services are less than 5% of the total value the reverse charge is not applicable.

Anything above 5% would mean that ALL supplies whether goods or services would be subject to the reverse charge.



2. Employment businesses

Surprisingly businesses supplying staff for construction services are not included in the reverse charge. This appears to be a loophole.

Where labour only services are provided, the reverse charge does apply. In this area therefore the issue of a supply of staff against a supply of services must be looked at; the former will not be affected by the reverse charge but the latter will.

This issue has already presented problems within, for example, the health sector where supplies of staff are taxable and supplies of health services are exempt.

Conclusion

We cannot rule out the possibility that HMRC will postpone this once again, or even withdraw the legislation completely.

Assuming it is introduced the default position will be that, where a business is VAT registered and within CIS, construction services other than those that are zero rated will be subject to the reverse charge. For those affected this will be a fundamental change because the default in relation to VAT is to charge VAT when in doubt.

While the law has been changed in respect to end users, we would urge that if in doubt the customer should be challenged. While stating that they will operate a light touch, we suspect that HMRC will pursue the supplier for VAT not charged where it is clear that the customer is the end user, even if the customer hasn't issued the end user notification.

This will be particularly true where the end user is unable to recover some or all of the VAT charged to them.

Please contact either your GE contact or the VAT team at VAT@geraldedelman.com if you have any questions.



Appendix 1 Legislation defining specified services and exclusions

1. Specified services

The following supplies of construction services ('specified services') are included in the reverse charge provisions.

These services are based on the definition of 'construction operations' used in the Construction Industry Scheme (CIS) under section 74 of the Finance Act 2004.

- (a) construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations;
- (b) construction, alteration, repair, extension or demolition of any works forming, or to form, part of the land, including (in particular) walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipe-lines, reservoirs, water-mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence;
- (c) installation in any building or structure of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection;
- (d) internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration;
- (e) painting or decorating the internal or external surfaces of any building or structure;
- (f) services which form an integral part of, or are preparatory to, or are for rendering complete, the services described in paragraphs (a) to (e), 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.

The reverse charge will include goods where those goods are supplied with the specified services.

The legislation **excludes** certain types of supplies of services. This is also based on CIS definitions under section 74 of the Finance Act 2004.

2. Excepted supplies

- (a) supplies of specified services to a person who uses those services for any purpose other than making further supplies of specified services; and
- (b) supplies of specified services to a person (A) who uses those services to make further supplies of specified services to another person (B) in circumstances where those further supplies are excepted under paragraph (a) and—
 - (i) A is connected with B,
 - (ii) A is a tenant, lessee or licensee of land, buildings or civil engineering works of which B is the landlord, lessor or licensor, or
 - (iii) A is a landlord, lessor or licensor of land, buildings or civil engineering works of which B is the tenant, lessee or licensee.

Unlike for CIS, there will be no deemed contractor provisions whereby purchases become subject to reverse charge because the purchaser buys a certain amount of such purchases in a given period.