



Changes to accounting for VAT in the Construction industry

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YEARS

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Significant changes will come into effect from 1 October 2019 for the way VAT is accounted for in the building and construction industry.

In circumstances where such changes apply, the person making the supply of services and receiving payment will no longer charge VAT. Instead, it will be the customer who is required to self-account for VAT. Clearly, this is very different to the way VAT is accounted for under normal circumstances and affected businesses will need to change their VAT accounting to ensure they remain compliant.

Reverse charge

The reverse charge (in 'VAT speak') is the 'self-accounting' referred to above.

Where it applies, the supplier, does not charge VAT. Instead, the customer/purchaser charges itself VAT by adding VAT to the purchase and accounts for the VAT in their VAT return.

The VAT the purchaser charges to itself can then be recovered, in the purchaser's VAT return, to the extent that they are able to recover VAT on the cost in question. So effectively, you revert to normal VAT accounting at this point.

If the purchaser is able to recover the VAT they have created via the reverse charge, the whole process becomes a mere accounting exercise, with no net VAT liability due overall as a result of the transaction.

Where the VAT is fully recoverable by the purchaser, the clear advantage to reverse charge accounting is that the seller and purchaser save the cash flow burden, where one collects and pays VAT to HMRC, whilst the other has to wait to reclaim it in their next VAT return.

Why are these changes happening?

The reason for the changes is to tackle VAT fraud in the construction industry, this being where in a supply chain, a seller of services disappears without paying the VAT it has charged over to HMRC. The purchaser however is able to recover the VAT, creating a fraudulent VAT loss to HMRC.

In what specific circumstances do these new rules apply?

Generally, it will apply to sub-contractors charging other sub-contractors (or the main contractor) for their supply of construction services i.e. business to business construction services from contractor to contractor.

Also, it will only apply where the supplier supplies services that are required to be reported under the Construction Industry Scheme ("CIS").

When does it not apply?

There will be some important exceptions and HMRC will issue penalties if VAT is not charged by a supplier, when it should have been and also where the purchaser has not met their obligations:

1. The reverse charge only applies to services at the standard or reduced rates of VAT i.e. 20% or 5%, it does not apply to zero-rated services.
2. It will not apply if the customer receiving the services is not registered for VAT.
3. Also, as mentioned above, it only applies where payments are required to be reported through CIS. So if CIS deductions are not required, the reverse charge will not apply. However, it is important to note that if the customer is an 'end user', see next point, even where CIS applies and/or the end user is CIS registered, the reverse charge does not apply, as end user status overrides this.

- Probably the most important exception, and the most challenging with regards getting this new VAT accounting correct, is the concept of 'end users'

End Users

The reverse charge will not apply to 'end users', end users being final customers of building and construction services.

By way of examples:

A main contractor invoicing the developer of a construction project will account for VAT (where applicable) in the normal way, as the developer is not using the purchased construction services to provide further construction services, so the developer is an end user.

A private person, purchasing building/construction work on their own private property, will also be charged VAT in the normal way, as again they are an end user, they are not purchasing the services to then supply on.

It will be up to the customer to make the supplier aware that they are an end user and they will need to do this by making a declaration to the supplier. HMRC seem to be saying that it will be the end user customer's responsibility to declare whether they are an end user, correctly, where they do so incorrectly they become liable to bring any VAT to account.

Connected parties, also referred to as intermediary suppliers will also be excluded from the reverse charge accounting.

Connected parties

Connected parties will charge VAT in the normal way and the new rules will not apply i.e. a contractor/sub-contractor that is connected to an end user.

By way of example, a property-owning group purchases construction services through

one member of the group and recharges those services to other group companies, or to tenants or both. All the members of the property owning group and their tenants will be end users and the reverse charge should not apply.

The concept of intermediary suppliers means that if a group of connected businesses collaborate to purchase construction services, they are all treated as end users and the reverse charge will not apply to their purchases.

Next steps and preparation

- Check if the reverse charge affects either your sales, purchases or both.
- Contact your customers and/or suppliers to let them know.
- Make sure accounting systems and software are able to deal with the new way VAT needs to be accounted for.
- Consider whether the change has an impact on cashflow, could it be a positive if your situation means VAT no longer has to be accounted for and recovered from HMRC.
- Will you be in mid contract on 1 October 2019 (when the rules take effect), will you need to change the VAT treatment.
- Consider how VAT will be accounted for in the VAT return.
- Consider how to determine the end user, and make sure you have procedures in place to be provided with the relevant declaration.
- There will be new invoicing requirements and specific legal wording required for reverse charge invoices.
- Do you have mixed supplies, some subject to reverse charge and some not, i.e. standard rated and zero-rated supplies.

Please contact our VAT specialist Jas Dhillon (jaspaldhillon@lubbockfine.co.uk) to discuss further.



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