

## VAT: Domestic Reverse Charge for Building and Construction Services

We have contacted you previously regarding the potential impact on your business of the above new regulations which initially were intended to be introduced on 1 October 2019 and we have subsequently had two delays to the implementation of this legislation. The new regulations are due to start on 1 March 2021 and with no signs yet of any further delay, we are encouraging clients to ensure they have considered the legislative requirements and ensure their software and procedures are in place to implement accordingly.

As a firm, Xero is our recommended software of choice and there is functionality within Xero for invoices to comply with the new legislation. We are aware that as of today's date Sage Cloud has the required functionality but some of the desktop versions may require updating to facilitate and Quickbooks are still developing their software for these requirements. If you use an alternative software system please ensure the software will cope with the reverse charge correctly with invoicing and VAT return purposes.

A simplified reminder of the changes is as follows but of course if you have any queries please do not hesitate to contact either myself or the client manager in charge of your affairs.

### **How VAT currently works**

A very simplified structure for a construction project could be as follows:

- **Developer** wants to build a project, enters into a building contract with a contractor
- **Contractor** agrees to build the project, enters into a building contract with the developer and a subcontract with a subcontractor
- **Subcontractor** agrees to help the contractor build the project, enters into the subcontract with the contractor

In this scenario the VAT broadly works as follows

- **Developer** pays VAT to the contractor on amounts invoiced by the contractor
- **Contractor** pays VAT to HMRC for works and services that it provides and pays VAT to the subcontractor for works and services that subcontractor provides and invoices to the contractor
- **Subcontractor** pays the VAT to HMRC on the works and services that it provides

You can see under this scenario that more than one party pay VAT to HMRC on the project.

### How is this changing?

From 1 March 2021 VAT will change for construction with the reverse charge VAT rules coming into force.

Under the reverse charge legislation the flow of VAT is going to change from a downwards process, as set out in the example above, to an upwards process. As set out below, under the new rules the 'recipient' of the works and services up the chain will, instead of paying the VAT to the party charging it, retain that VAT and pay it to HMRC.

### What does this mean in practise?

For the above the change would work like this:

- **Developer** is the last party in the chain and is the end user of services so as before the developer pays the VAT to the contractor
- **Contractor** is now the last recipient of the works and services before the end user so it retains the VAT chargeable on the invoice supplied by the subcontractor (instead of paying the VAT to the subcontractor). It then pays the VAT to HMRC. In this scenario the contractor accounts for the full amount of VAT expressed on the invoice to the developer whereas in the past it would have effectively only accounted for the amount on which that exceeds the input VAT which the contractor itself has been charged by the subcontractor
- **Subcontractor** is not the last recipient of the works and services before the end user so no longer pays the VAT to HMRC on the works and services that it provides as this is done on its behalf by the contractor. It will still invoice the contractor for VAT (adjusting the invoice to reflect the supply is subject to VAT domestic reverse charge) however the contractor will withhold the VAT from its payment to the subcontractor. On the subcontractor's VAT return the value of sales subject to DRC are still included in box 6 of the return as normal but no output VAT is recorded in box 1 as this is accounted for by the contractor

As demonstrated above, only one party, being the contractor in this example, pays VAT to HMRC on the entire project.

Under the legislation if you supply building and construction services there are some additional checks that you need to complete including:

1. ensure your customer has a valid VAT number
2. check your customer's CIS registration
3. review each contract to decide if the reverse charge will apply and tell your customers
4. ask your customer to confirm whether they are the end user or intermediary supplier
5. ensure your software can deal with reverse charge accounting.

In terms of points (1) to (4) I attach a proforma letter that you might find useful to issue to customers to help with these obligations. Of course, if you have any queries please do not hesitate to contact either myself or your client manager.