

Domestic Reverse Charge for Building and Construction Services

The Domestic Reverse Charge (DRC) is being introduced from 1 March 2021. The new reverse charge is the latest version to combat missing trader or carousel fraud that first appeared in relation to precious metals, computer chips and mobile phones. Due to both the Covid pandemic and preparations relating to Brexit, the introduction has been delayed twice. The DRC will affect businesses that:

- Buy or sell services that are 'specified services' that are reported within the Construction Industry Scheme (CIS)
- The supplier and the recipient are both registered for VAT in the UK
- The supply is standard rated or reduced rated.
- The supply is not to the end user or an intermediary

Supplies of zero rated construction services are not included within DRC. For example, construction services on a new build house will be invoiced as normal under the current regulations.

What are specified services?

You must use the reverse charge for the following services which are reported within CIS:

- constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services
- constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours, pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence
- installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure
- internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration
- painting or decorating the inside or the external surfaces of any building or structure
- services which form an integral part of, or are part of the preparation or completion of the services described above - 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

Who are end users and intermediary suppliers?

The end user is the final customer. These can be businesses that are registered for CIS but will not be making onward supplies of the building and construction services supplied to them.

An intermediary buys the construction services and re-supplies them to the linked end user without making material alterations to the supplies.

The end user must provide written notification to the supplier to advise they are the end user. An example of the wording to use is, '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.'

Continued overleaf

Current process within the supply chain

Currently:

- Subcontractors invoice the main contractor charging VAT where necessary;
- The subcontractor declares the VAT as output tax to HMRC;
- The contractor pays the subcontractor and claims the VAT back from HMRC as input tax.



HMRC have found that in certain situations, subcontractors are getting paid (inclusive of VAT) from the main contractor but then not declaring the VAT to HMRC.

Process under the Domestic Reverse Charge

The new accounting process will be as follows for 'specified supplies':

- Subcontractor invoices the main contractor (without VAT) and states on the invoice that this should be processed through the reverse charge
- The contractor pays the subcontractor (without VAT)
- The contractor declares the output tax relating to the subcontractors' invoice (what VAT the subcontractor would previously have paid to HMRC)
- The contractor claims input tax (the same amount as the output tax)
- The contractor invoices the end user as normal (not including the subcontractors VAT)



Checking if the subcontractor is CIS/VAT registered

The reverse charge only applies to CIS and VAT registered businesses. So, if the subcontractor or contractor is not VAT registered or CIS registered, then normal rules apply.

You should ask any new subcontractors to provide details of their registration as a contractor for CIS purposes or a copy of their CIS verification. These should be retained.

Invoices

The main contractor must also confirm if they are providing services to the end user before sending an invoice. If contractors are supplying services to the end user, then the invoice is issued under normal VAT rules.

If a subcontractor undertakes reduced rated or standard rated services, they will issue an invoice to the main contractor with no VAT charged. The invoice the subcontractor issues should make it clear that the services fall under the domestic reverse charge.

The invoice must clearly state how much VAT is due under the reverse charge, or the rate of VAT if the VAT amount cannot be shown, but that VAT should not be included in the amount charged to the contractor.

Cashflow - Subcontractor

As a result of the reverse charge, subcontractors will be paying VAT to suppliers on purchases but will no longer receive VAT within their payments from the main contractor. This may affect cashflow and businesses should prepare for this change.

As subcontractors no longer pay the VAT on some of their sales to HMRC but will still be reclaiming VAT on purchases, they will likely be in receipt of regular repayments of VAT from HMRC. Businesses within a repayment position can apply to move to monthly returns to speed up payments due from HMRC. This change will assist with cashflow.

Continued overleaf

If you would like to discuss this in further detail, please get in touch.

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Cashflow – Main Contractor

The main contractor will no longer be charged VAT by the subcontractors but will still be required to pay VAT direct to HMRC. The contractor will reclaim the VAT as usual on the same VAT return.

The main contractor may pay the VAT to HMRC at an earlier point than when they normally paid the subcontractor. The main contractor will need to plan for this potential change in cashflow.

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