

## UK to implement domestic reverse charge on construction services as of 1 March 2021

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### Executive summary

The new United Kingdom (UK) Value Added Tax (VAT) domestic reverse charge is expected to be introduced with effect from 1 March 2021 (following two delays, most recently as part of HM Revenue & Custom's (HMRC) COVID-19 measures). The reverse charge will apply to supplies of construction services between VAT-registered subcontractors and contractors, which must be reported for Construction Industry Scheme (CIS) purposes.

The aim of the new legislation is to tackle perceived VAT fraud in the construction sector known as "missing trader fraud," whereby VAT is charged by the supplier but is not remitted to HMRC.

### Detailed discussion

#### Who is affected?

Businesses making or receiving supplies of "construction" services, which must be reported for CIS purposes, will be affected by the change (provided those services are subject to VAT at the standard or reduced rate, the reverse charge will not apply to supplies subject to the zero rate of VAT).

The definition of "construction services" for the purposes of the reverse charge is based on the definition used in CIS and therefore includes (but is not limited to):

- ▶ Construction, alteration, repair, extension, demolition or dismantling of buildings or structures
- ▶ Construction, alteration, repair, extension or demolition of any works forming part of the land including walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, railways, pipe-lines, reservoirs, water-mains, wells and sewers
- ▶ Installation of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection
- ▶ Painting or decorating the internal or external surfaces of any building or structure
- ▶ Site clearance, excavation, laying of foundations, erection of scaffolding and site restoration

## Exclusions

The domestic reverse charge is not designed to apply to services received by "end users" or certain intermediaries. "End users" are those who receive the construction services for their own use, and do not make an onward supply. Intermediaries connected with the end user of the service (such as a group company), or intermediaries who share a relevant interest in the property for which the supply is made with the end user (such as landlords and tenants), may also be treated as "end users" for the purposes of the domestic reverse charge.

However, in order to ensure that the domestic reverse charge does not apply, end users and relevant intermediaries would need to make the necessary notification of "end user status" to their suppliers. This should be done in writing and may be incorporated into a contract. In the absence of notification, the domestic reverse charge would apply. Based on the guidance and legislation, there is nothing to compel a business to notify. However, we understand that it may be preferential for some businesses to continue to incur VAT as normal, without the need to make changes to the VAT accounting systems and processes. However, for others, the cash flow benefit of applying the reverse charge, or the uncertainty around end user status in some arrangements, make it more appealing not to issue any written notification.

## HMRC guidance

HMRC has issued guidance on the topic in order to provide clarity around some areas of uncertainty including:

- ▶ The practicalities of the customer identifying themselves as an "end user" as well as suggested methods of notification
- ▶ The 5% disregard rule whereby if the value of services subject to the domestic reverse charge is 5% or less of the value of the whole supply, the reverse charge element may be disregarded, and normal VAT rules apply
- ▶ Information to include on a VAT invoice where the reverse charge applies
- ▶ The initial light-touch approach to be applied to penalties for businesses acting in good faith
- ▶ Clarification around supplies of staff (e.g., by recruitment agencies) and confirmation that they should not be caught by the domestic reverse charge provisions

## Next steps

Businesses should consider steps to be ready for the reverse charge which comes into effect from 1 March 2021.

Specifically, businesses may:

1. Review supply chains and assess whether supplies of construction services, which fall within CIS (and are subject to the standard or reduced rates of VAT), are being received/supplied
2. Update invoice templates to include a reference to the domestic reverse charge (e.g., "Reverse charge: Customer to pay the VAT to HMRC") along with the amount of VAT due under the domestic reverse charge
3. Create new tax codes to account for supplies made and received which are subject to the domestic reverse charge
4. Ensure staff are trained and a process is in place to treat relevant supplies as subject to the reverse charge
5. Assess whether the business will receive any excluded supplies as an end user or intermediary supplier. Particular attention should be given to whether intermediary supplier rules apply to joint ventures entities and entities with minor land interests
6. Where applicable, prepare and implement a process for issue of end user notifications if a business wishes to be charged VAT by the supplier. Suppliers should also prepare and implement a process to capture notifications received
7. Undertake contractual reviews and make any necessary amendments

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