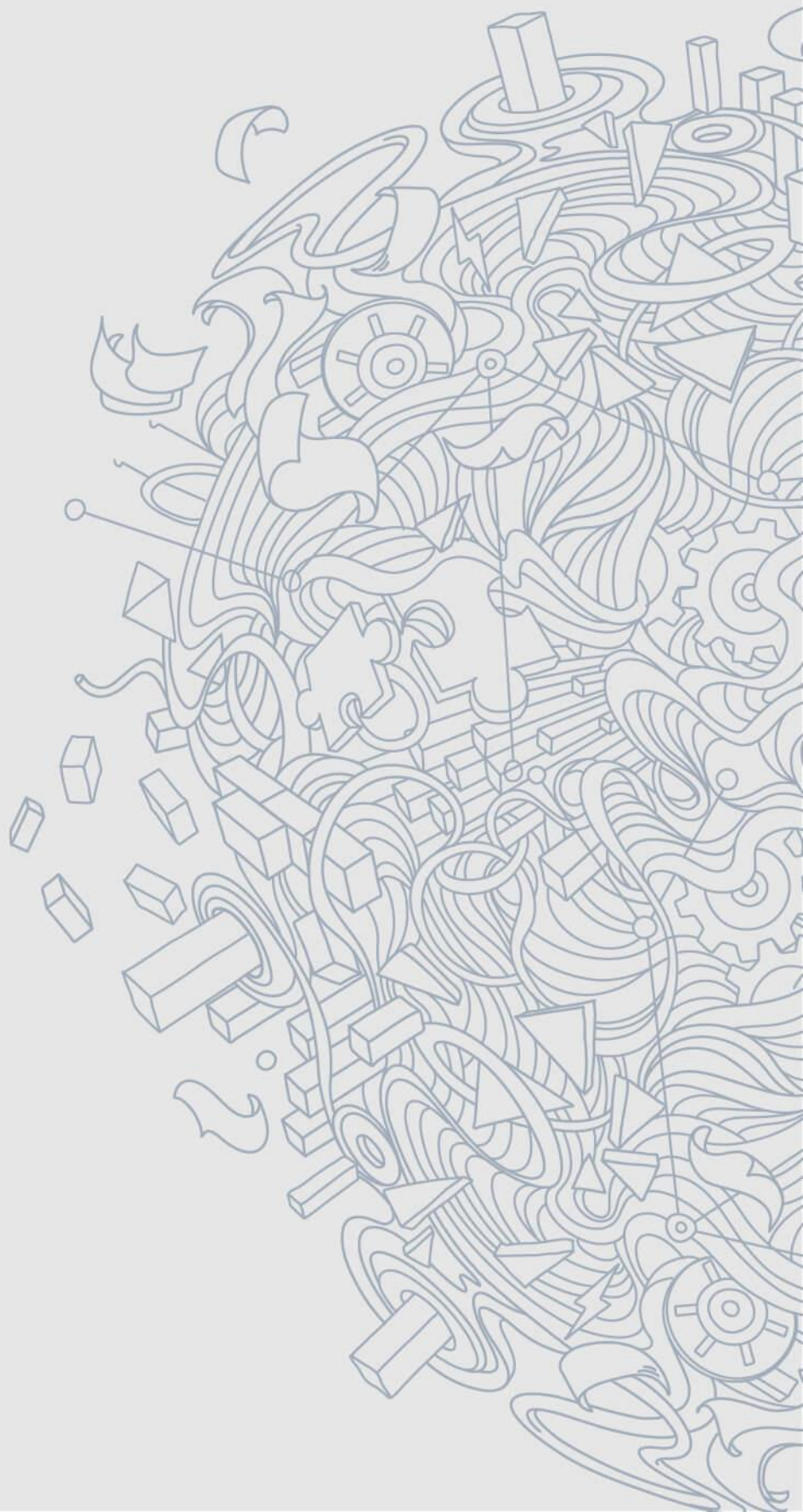


INTRODUCTION TO THE NEW VAT REVERSE CHARGE ON CONSTRUCTION WORK

FEBRUARY 21 UPDATE



INTRODUCTION TO THE NEW VAT REVERSE CHARGE ON CONSTRUCTION WORK (FEB 21 UPDATE)

- A new VAT reverse charge mechanism is being introduced to combat VAT fraud in the construction industry.
- As from 1st March 2021, customers – but not final customers - will be responsible for accounting to HMRC for VAT on construction services and associated goods.
- On most projects this means that the main contractor will pay his subcontractors net. "End users" who confirm their status to their supplier will not need to apply the reverse charge.
- The change will lead to additional provisions in new contracts. Parties to existing contracts will need to confirm relevant information as soon as possible to ensure payments are made correctly and to enable them to rely on the end user exception (if applicable). Generally accounting and invoicing procedures will need to be reviewed and updated.

WHAT'S IT ABOUT?

- Changes to VAT legislation were first scheduled to come into force on 1st October 2019 in a bid to stop rogue suppliers in the construction industry charging their customers VAT, but then failing to pay it over to the Exchequer. Having been deferred twice the changes come into force on 1st March 2021. The changes take the form of a new reverse charge on the supply of construction services and associated goods, meaning that the relevant customer will be responsible for accounting to HMRC for the VAT, rather than the supplier. The term "construction services" is widely defined in the new Order and is intended to have the same scope as construction operations under the CIS. Amongst other things it does not include the professional work of consultants, the manufacture or delivery of certain components, the installation of security systems or drilling for or extraction of oil or natural gas or of minerals (and associated specified activities). Unlike the CIS, the reverse charge applies to materials supplied with services as part of a single supply.
- A mixed supply, which includes construction services and other services, is treated as a supply of construction services for the purposes of the legislation and is subject to the reverse charge, for example design and build works and supply and fix works.

EXCEPTIONS TO THE REVERSE CHARGE

- The reverse charge will not apply if the supplier or customer is not (and is not required to be) VAT registered, or if the customer is not receiving the supply in connection with the carrying on by him of any business. Zero rated supplies also fall outside the reverse charge, as do supplies by non-UK businesses, which are already subject to an existing reverse charge.
- Supplies in respect of which payment is not reported within the Construction Industry Scheme are also not subject to the reverse charge.
- Article 8 of the Order identifies certain supplies which are excepted from the reverse charge, subject to a right for the parties in certain circumstances to agree to the contrary. For a supply to be excepted the whole of the relevant supply must fall within the exceptions. Notably the exceptions include supplies to "end users" and to persons who are "intermediary suppliers" connected with an expected end user in each case provided that they have notified the supplier of their status. "End users" are taxable persons receiving specified services who use those services "for any purposes other than making further supplies of specified services" which will include employers carrying out works for their own occupation or who own the site and wish to sell or lease the completed development. The connected intermediary supplier exception will apply to companies procuring works for an expected end user who is within the same corporate group (defined by reference to S1161 of the Companies Act 2006) and who do not make any material alteration or further processing as part of the onward supply.
- A further exception applies to supplies to intermediary suppliers in relation to land, buildings or civils works in which both the intermediary supplier and the expected end user of the services have a relevant interest in the land (but not temporary rights to occupy the land). This exception would apply, for example, in respect of supplies to an employer who is a landlord (or prospective landlord where there is an agreement for lease) carrying out works for his tenant, provided that he doesn't make any material processing or further alteration as referred to above.

To benefit from the exception an end user or excepted intermediary supplier must either not later than the time the supply is made have confirmed in writing (eg by letter or email) that it is an end user or excepted intermediary supplier or received the supply under a written agreement which confirms this status in relation to any supply under the agreement. HMRC suggests that the following wording could be used to notify a contractor of end user status (eg in an email):

"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.'

HOW WILL THE REVERSE CHARGE WORK IN PRACTICE?

- In cases where the employer is an end user or excepted intermediary supplier he will pay VAT to the main contractor in the usual way, and the main contractor will in turn account to HMRC for that VAT.
- Going further down the supply chain, the main contractor will then be the customer and will be required to account for VAT on relevant supplies he receives from sub-contractors as output tax. He can recover the VAT as input tax (subject to the normal rules on VAT recovery), meaning that it will have no net effect on the main contractor. Sub-contractors will not charge VAT to the main contractor, and will be paid net.
- If the employer is not an end user (or does not fall within one of the other exceptions) the reverse charge will apply to him, and he will not pay VAT to the main contractor, but will instead pay it to HMRC direct. The main contractor and sub-contractors down the chain will not charge VAT.

WHY DOES IT MATTER?

- The changes have a significant impact on the way in which VAT is accounted for. Where the reverse charge applies a supplier should not charge VAT.
- HMRC guidance indicates that a light touch will be applied in dealing with errors in the first 6 months of the new legislation, as long as the person is trying to comply with the legislation and has acted in good faith and states that penalties will only be considered during this period for anyone deliberately taking advantage of the measure by not accounting for VAT correctly.
- This change is also important to the construction industry as a whole as it will affect cashflow, as suppliers will no longer be holding VAT amounts. For main contractors this is likely to have an adverse impact, for other suppliers it may prove a benefit. Companies will need to assess what impact it will have on cash flow and seek to mitigate any adverse effects.
- The changes will necessitate a review of and changes to companies' accounting systems and software. Initially, uncertainty and the need to obtain information may delay payments as payers and suppliers check whether the reverse charge applies.

NOW WHAT?

INFORMATION

- The parties to a contract for construction services must know both (a) their (and their counterparty's) status so far as relevant to the rules (eg VAT registered/acting in a business capacity/subject to an exception/UK entity) and (b) that of the services/works being provided in order to implement this change.
- In particular, it is important for the parties to a main contract to know whether the employer is an end user or an excepted intermediary supplier and for this to be confirmed to the contractor. When considering this issue, it is important to look at the structure of the transaction and the relevant land interests, rather than way in which the employer is referred to – for example the term "Developer" has a variety of different meanings and could cause confusion.
- If there is doubt as to whether the supply is of construction services the HMRC guidance indicates that if the payment is subject to CIS the reverse charge should apply.
- The required information does not need to be set out in the contract, although for new contracts it would be sensible to include appropriate provisions confirming relevant matters in the same way as the Contract Particulars in the JCT confirm whether the employer is a contractor for the purposes of CIS. There should be a linked obligation to notify the other party of any changes to the information provided. Further additional provisions may be required, for example in relation to invoicing procedures. For existing contracts, the parties should seek to clarify these matters and the employer should confirm its status in writing to the contractor as soon as possible.

ACCOUNTING, INVOICING AND PAYMENT PROCEDURES

- Payers will need to ensure that any VAT charged is properly payable and initially additional information and checks will be required. Companies should consider whether changes are needed to their payment procedures to protect against VAT being paid in respect of an incorrect demand and staff training will be required. In turn, suppliers must not charge VAT and will need to ensure that their invoices comply with HMRC requirements including stating on the invoice that the reverse charge applies and that the customer must account for VAT on relevant items and stating the amount of VAT due (or the relevant rate where this is not possible). Generally changes are likely to be required to accounting systems and software.

- If any mistakes are made following implementation they should be notified to HMRC as soon as possible, as the longer under declared or overcharged sums remain outstanding the more difficult it may be to correct or recover them.
- Payments due to be made around 1st March will require careful review to establish which regime applies. For invoices issued for specified supplies that become liable to the reverse charge, the normal VAT rules apply to invoices with a tax point before 1 March 2021 and the reverse charge will apply to invoices with a tax point on or after 1 March.
- Businesses which move to a position where their VAT return is a net claim and not a net payment should consider whether to move to monthly returns to speed up the repayments due from HMRC.
- For further information in relation to the reverse charge see the HMRC VAT Reverse Charge Technical Guide.

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