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Domestic VAT reverse charge for Building and Construction Services

Following two previously announced delays the new **Domestic Reverse VAT Charge for Construction Services ("DRC")** will come into force on Monday 1st March 2021.

With the aim of eliminating VAT fraud in the construction sector, the reverse charge mechanism shifts the liability for accounting for output VAT (VAT on sales invoices) from the supplier to the customer.

It will require the recipient of the service rather than the supplier to account for the VAT due on certain construction services directly to HMRC. The recipient (the customer) will account for the output **and** the input VAT.

Who will the DRC apply to?

DRC will only apply to transactions that are both reported under CIS and between VAT registered contractors and subcontractors.

DRC **will not** apply in the following cases:

- Zero-rated supplies;
- Services supplied to an end user (such as the property owner), or directly to a main contractor (an intermediary supplier) that sells or lets a newly completed building;
- When the recipient makes onward supplies of construction services to a connected company;
- When the recipient is not VAT registered, or required to be VAT registered; and
- When the recipient is not registered for the CIS.

An end user is a consumer and final customer that is VAT & CIS registered **but** does **not** make onward supplies of the building and construction services supplied to them.

Intermediary suppliers are VAT & CIS registered who are connected or linked to end users. To be connected, the intermediary supplier must either:

- Have a relevant interest in the same land where the construction works are taking place, e.g. landlord or tenant; or
- Be part of the same corporate group or undertaking.

An amendment to the original legislation has made it a requirement that businesses who are end users or intermediary suppliers, being excluded from the reverse charge, must inform their suppliers, in writing, of same. This can be provided with on paper and sent by post, electronically in an email or in a contract. It is not the supplier's responsibility to ask for this.

How will DRC impact invoicing?

The date DRC applies on certain projects/contracts will depend on the tax point. In most cases, this will be the date a VAT invoice is issued or receipt of payment, whichever occurs first.

For invoices issued:

- before 1 March 2021 with a payment date on or before 31 May 2021 - use normal VAT rules;
- before 1 March 2021 with a payment date on or after 1 June 2021 - use DRC rules; and
- on or after 1 March 2021 - use DRC rules.

There may, however, be instances where payment has been received before an invoice was issued, meaning the 'Time of Supply' rules will be appliable.

Should you need additional guidance on 'Time of Supply' rules please contact us.

As a subcontractor (issuing sales invoices):

- DRC will mean a change to your invoice issued to the contractor on which the contractor will pay the VAT directly to HMRC (details on what additional information to include on your invoice are noted below);

- You may find cashflow affected as the VAT you previously held before passing monthly/quarterly to HMRC as a payment will no longer be available as you will no longer receive this;

- You will no longer be paying VAT on sales to HMRC; therefore you may find you are often in a VAT repayment position. You may wish to change to monthly VAT returns in order to receive repayments more quickly and help cash flow; and

- When completing your VAT return, you must **not** enter any VAT relating to DRC in Box 1, but you must enter the value of DRC sales in Box 6.

Additional details to be included on your DRC invoice are:

- VAT rate (5% or 20%) or VAT amount due under the DRC (but this amount must not be included in the total amount charged to your customer);

- A note that *reverse charge applies*; and

- A note that *customer to account to HMRC for the reverse charge output tax on the VAT exclusive price of items marked 'reverse charge applies' at the relevant VAT rate as shown*.

As a contractor (receiving sales invoices from your subcontractor):

- DRC will mean when you receive the reverse charge VAT invoices from your subcontractor, you must ensure to account for them correctly and pay any VAT due to HMRC as part of your normal VAT compliance;

- You will continue to apply CIS rules on these invoices also, paying CIS to HMRC;

- When completing your VAT return, you must enter in Box 1 the VAT due in relation to DRC, but you must not enter any value in Box 6, and as normal, you will reclaim the VAT suffered in relation to DRC in Box 4 with the net value of the purchase in Box 7.

Supplies where the reverse charge element is a minor part

If the work that falls under CIS is 5% or less of the total invoice, DRC will not be used and normal VAT rules are applied. For example, installation of a security system does not fall under DRC, but installation of lighting does. If the cost of installing lighting is less than 5% of the total invoice for installation of a security system and lighting, then the normal VAT rules will apply.

Interaction of DRC and other VAT accounting schemes

The Cash Accounting Scheme is when you account for VAT based on when payments are made and received. Unfortunately, you cannot use the Cash Accounting Scheme when DRC is applicable, resulting in the following changes:

- For sales:
    - No output VAT will be due on payments from customers when the supply is covered by the DRC;
    - You will include in Box 6 the value of the sale when payment is received; and
    - If you supply services that are not subject to DRC, for example to private individuals or end users, you must account for the VAT on the dates you were paid.
- For purchases:
    - if you receive an invoice subject to DRC, you will have to account for both output and input VAT simultaneously on the same VAT return at the tax point date i.e. invoice date and not the date you paid the supplier – whichever is first.

DRC supplies are not to be accounted for under the Flat Rate Scheme. If you receive DRC supplies, you will have to account for the output and input VAT simultaneously on the same VAT return. If you are currently using the Flat Rate Scheme you will have to consider if it is still beneficial to you, bearing in mind that under this scheme you cannot recover VAT incurred on purchase of material, overhead etc.

HMRC Guidance on DRC can be found at https://www.gov.uk/guidance/vat-reverse-charge-technical-guide

Should you need to discuss your position in more depth and confirm processes applicable to you please do not hesitate to contact your client contact or Orla Mallon, Chartered Tax Advisor.

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