VAT alert

HMRC Publishes Guidance on Domestic Reverse Charge

June 2019

Summary

HMRC has published guidance for businesses impacted by the new Domestic Reverse Charge (DRC) which is to be introduced for certain supplies in the construction sector from 1 October 2019.

In normal circumstances, it is the supplier of goods or services that charges and accounts for VAT. However, in certain circumstances, HMRC may designate the customer as the person liable to pay any VAT due. In a move to combat what is perceived to be widespread VAT evasion in the construction industry, customers will be required from 1 October 2019 to account for output VAT in relation to certain supplies.

The supplies in question are those supplies that would generally be reportable by a contractor under the Construction Industry Scheme (CIS). However, there will be a few exceptions.

Affected businesses need to understand the new rules, inform affected personnel and departments internally and, where necessary, take steps to amend their accounting procedures. The new rules will apply to existing contracts that span the date of implementation.

VAT accounting rules to change in the construction industry

The Government announced last year that it was to introduce a new 'domestic reverse charge' in the construction industry to counter what it perceives to be widespread VAT fraud in the sector. Under the existing VAT system, suppliers of construction services charge VAT to their customers and should declare that VAT to HMRC. Unfortunately, some suppliers fail to account for the VAT charged. The domestic reverse charge is intended to remove this problem by making it the responsibility of the customer to account for the VAT due. In simple terms, the customer will, in effect, charge VAT to himself and then reclaim it if he is entitled to do so on the same VAT return. This procedure removes the opportunity for the supplier to collect the VAT due and then disappear without paying the VAT over to HMRC.

The new system is to come into effect on 1 October 2019. Affected businesses need to get to grips with the new rules and apply them from that date. HMRC has now issued guidance on how the new system will work in practice. The general rule is that supplies will be subject to the domestic reverse charge if they are reportable under the Construction Industry Scheme (CIS). Businesses involved with the construction, alteration, repair, demolition or dismantling of structures attaching to the land including walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours etc will be subject to the reverse charge (the list is not exhaustive) and applies equally to existing structures as well as to new projects that are started after 1 October 2019. However, the reverse charge will not apply if the 'customer' is (or is to be) an 'end-user' of the finished structure. Suppliers of these typical construction services will, therefore, need to establish the status of their customer for both existing contracts and at the outset of any new contracts. For these purposes, a customer will be an 'end-user' if he will use the services relating to the structure for his own purposes rather than as part of his own supply of construction etc services to his customer.

It will also be important to confirm with customers what their CIS status is in relation to the proposed works. This can be done either by asking customers for verification or by accessing HMRC's online CIS verification system or through use of commercial CIS software.

Depending on the contractor's position in the supply chain, the new reverse charge system could have a positive or negative impact on cash-flow as suppliers will no longer charge and collect VAT in qualifying CIS reportable transactions. Such contractors will no longer have use of the VAT collected from customers between the date of receipt of payment and the date of the relevant VAT return. Affected contractors will need to plan their finances accordingly. On the flip side, purchases of qualifying services will no longer be required to fund the VAT payable to the contractor and then reclaim the amount through their VAT return.

Conclusion – the new rules are intended to make the incidence of VAT fraud in the construction industry much lower than at present. To that end, the new system should be welcomed. However, the services to which the scheme will apply are far wider than was initially anticipated. The majority of CIS reportable transactions will be caught by the new rules and affected businesses need to take note and put in place accounting and other procedural and process changes now so that they can apply the reverse charge from 1 October 2019. To discuss these changes in more detail, please contact your usual Grant Thornton VAT contact.

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