



VAT alert

VAT Reverse Charge for Construction Services

November 2018

Summary

HMRC considers that it is necessary to introduce new legislation to counter what it says are organised criminal attacks on the UK's VAT system in the construction sector.

It has published a final version of the draft legislation which will introduce a VAT domestic reverse charge for building and construction services with effect from 1 October 2019. This follows a technical consultation on the proposed legislation carried out during 2017. The new draft legislation reflects the views of affected businesses and stakeholders.

A domestic reverse charge transfers the liability for accounting for VAT from the supplier to the customer. The customer accounts for the deemed VAT due on the supply instead of the supplier and then decides whether it is able to reclaim this deemed VAT through its VAT return.

This mechanism means that VAT chargeable by the supplier cannot go 'missing' if the supplier fails to pay over the VAT collected from the customer. This mechanism was introduced to deal with the threat to the Revenue arising from 'missing trader' [MTIC] or Carousel fraud and is to be extended to services within the construction sector.

Affected businesses will need to amend their VAT systems and processes and train relevant staff.

HMRC publishes new guidance on the proposed reverse charge

Following a consultation in 2017, HMRC has now published a new draft statutory instrument intended to introduce a domestic 'reverse charge' for certain services within the construction sector. HMRC considers that it is necessary to introduce the measure to protect the UK's VAT system from organised criminal attacks.

The problem

For many years, the EU's VAT system (including the UK's) has been under attack from what has become known as MTIC (Missing Trader Intra-Community) Fraud. Under such an attack, a supplier will charge VAT to a customer but will 'disappear' before paying that VAT over to the tax authority. The purchaser will generally have a right to reclaim the VAT paid over to the supplier through its VAT return which causes a 'gap' in the respective Treasury's VAT receipts. A reverse charge mechanism was introduced to combat this fraud some years ago. The mechanism relieves the supplier from his usual obligation to charge and account for VAT and transfers that obligation to the purchaser. In simple terms, the purchaser accounts for the output VAT due on the supply and generally reclaims the VAT accounted for in this way as input tax through its VAT return.

A similar kind of attack has been taking place in relation to supplies within the construction industry and this reverse charge mechanism is seen as a solution to the problem. It has already been introduced in other Member States across the EU.

The Solution

HMRC has now published a revised draft of the statutory instrument that will introduce a reverse charge for certain services within the construction sector. The new reverse charge will be effective from 1 October 2019. The new reverse charge will affect supplies that are liable to VAT at either the standard rate of 20% or the reduced rate of 5% and will only apply to payments that are covered by the Construction Industry Scheme (CIS). In other words, only services that are supplied between sub-contractors and main contractors will be subject to the reverse charge unless the purchaser is regarded as an 'end user'. End users will usually be recipients that use the building or the construction services in question for their own purposes rather than to sell-on those services as part of its own supply of construction services. Such 'end users' will need to provide written confirmation to their suppliers that they qualify.

Services covered by the reverse charge

The reverse charge will cover among other things the supply of services covered by the CIS including those of construction, alteration, repair, extension, demolition or dismantling of buildings or structures. It will also cover services such as the installation of heating, lighting and cooling systems and the provision of power, drainage and sanitation etc. The reverse charge will also apply to internal cleaning of buildings and to the painting and decorating of buildings and structures.

Comment – Businesses within the sector need to familiarise themselves with the new reverse charge accounting requirements. HMRC says that it will apply a light touch to any accounting errors that occur within the first 6 months. After that, HMRC is likely to seek the imposition of financial penalties where affected businesses fail to comply with the new rules.

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