BCLP. Client Intelligent

Insights

VAT REVERSE CHARGE

Sep 04, 2019

UPDATE: Following a change in law the VAT reverse charge will now be introduced from 1 March 2021. This article should be read with this development in mind.

What is the reverse charge?

Coming into effect on 1 October 2019, the *reverse charge in relation to building and construction services* is set to bring about a major change in how VAT is handled in the construction sector. All those involved – including developers – need to be aware of when it will apply and how it will work.

The reverse charge will require the recipient of services, rather than the supplier, to account for VAT. This requirement will apply throughout the chain of suppliers, up to the point where the recipient of the services is an "end user". The "end user" concept is critical and we will look at this in more detail below.

Why is it being introduced?

HMRC has for some time been concerned at the alleged prevalence of "missing trader fraud" in the construction industry. Missing trader fraud is where a supplier charges VAT on the supply of labour or materials, and then disappears without accounting for the VAT to HMRC. According to HMRC estimates, the loss to the revenue may be as much as £100m per annum.

The reverse charge is HMRC's way of tackling this problem. However, it goes far beyond targeting the "rogue traders" who are presumably responsible for this missing money. Indeed, as drafted it will catch construction suppliers of all sizes, right up to some of the biggest companies in the UK.

To those who protest that this indiscriminate approach will impose an unnecessary burden on reputable firms, HMRC's response appears to be that "big business can cope" and that we will all soon get used to it. That may be so, but it hardly chimes with the Government's declared aim to reduce red tape, nor with the "supporting SMEs" agenda.

Scope of the reverse charge

The reverse charge will affect only "specified supplies". Generally, these are supplies which are chargeable to VAT (either at standard or reduced rates) where payment is required to be reported through the Construction Industry Scheme (CIS). More specifically, the types of supplies covered by the reverse charge are closely aligned to those defined as "construction operations" in the CIS. So supplies of services such as the construction, alteration, repair, extension or demolition of buildings, structures or walls are potentially subject to the reverse charge.

Professional services (such as the work of architects, engineers and surveyors) will not be subject to the reverse charge when supplied on their own. However, they will be if they form part of a single supply of construction services, for example by a design and build contractor.

All supplies made after 1 October 2019 are potentially subject to the reverse charge, even where they are made pursuant to agreements entered into before that date. Therefore, parties to such agreements will need to revise their payment systems to ensure that they correctly apply the rules after 1 October 2019.

The reverse charge in practice

Where the reverse charge applies, the recipient of the service will have to account for the VAT to HMRC via its VAT return, instead of paying the VAT to its supplier. The recipient will still be able to recover the VAT it incurs as input tax in the normal way. Also, the supplier must still issue a VAT invoice which must indicate that the supplies are subject to the reverse charge. The amount of VAT due should still be stated, but it should not be included in the total VAT charged figure.

If a supplier is providing services to an end user (see below), it is up to the end user to inform the supplier that they are an end user and that the supplier should charge VAT in the traditional way. HMRC recommends that this notification should be in written form, so that it can be retained for future reference. There is no set formula, but HMRC suggests the following as an example of suitable wording:

> "*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.*"

The "end user" exemption

As noted above, the reverse charge will not apply where the supply is to an end user. There are three categories of end user recognised by the Regulations:

- Those who do not make onward supplies of construction services at all (for example, owner-occupiers);
- Those who make onward supplies to a "connected person" – broadly, those who fall within the definition of group companies in the Companies Act; and

- Where the supplier and the recipient both have a “relevant interest” in the property to which the supply relates.

It is in the last of these cases where difficulties are most likely to arise. The examples given by *HMRC in its guidance* are generally obvious; for example, a tenant who makes onward supplies to its landlord (or vice versa), or a developer/landlord constructing a building for a prospective tenant under an agreement for lease. However, suppose the developer sells the land to an investor up front and is then retained to procure the construction (the so-called “Prudential” structure, which is a very commonly used and entirely legitimate SDLT saving measure). In that case the developer is not an end user (because it no longer owns the land), so the reverse charge will apply to its building contract. But – remembering the mischief at which the reverse charge is directed – why should an accident of the property owning structure make such a big difference to the VAT treatment?

The position is even more surprising if a land sale happens part way through construction. In that case the reverse charge will apply only to those supplies made after the sale takes place. So the parties to construction contracts will need to be aware of this, and to make provision in their contract for the possibility of a future sale or other change in VAT status during the works.

What’s more, HMRC suggests that the recipient (employer) should communicate to the supplier (contractor) whether it is an end user. However, most construction employers aren’t VAT experts and it simply may not occur to them that there is an issue.

Unfortunately, the JCT (the publishing body for standard form building contracts in the UK) has decided not to issue amendments to its standard forms to deal with this point. Lawyers advising employers and contractors will therefore need to cover the position by way of bespoke amendments. Thankfully *Practical Law Construction has developed a set of clauses* to help them, which requires the contractor to ask the question (are you an end user?) each time that it applies for payment. This will at least remind the parties to think about the reverse charge issue.

What happens next?

HMRC appreciates that the new rules may cause “initial confusion”. It has indicated that it will accept errors made “in good faith” in relation to the reverse charge for the first 6 months of its application.

With respect, we think this is a significant understatement. We fully expect that all parts of the industry will struggle to get to grips with the rules and that there will be widespread (innocent) non-compliance in the early days. However, HMRC has been deaf to the industry’s lobbying so far, although a group of 15 construction trade bodies has now written to the Chancellor of the Exchequer flagging the cashflow impact of the changes and urging him to defer them by at least six months. We wait to hear Sajid Javid’s response. Meanwhile, any financial institution which is

funding a contracting business will need to take into account the adverse cashflow impact of the charge on the contractor's working capital.

This article first appeared on the Practical Law website.

RELATED CAPABILITIES

- Infrastructure
- VAT & Indirect Taxes

MEET THE TEAM

Alan Sinyor

London

alan.sinyor@bclplaw.com
+44 (0) 20 3400 4048

Shy Jackson

London

shy.jackson@bclplaw.com
+44 (0) 20 3400 4998

James Clarke

London

james.clarke@bclplaw.com
+44 (0) 20 3400 3507