

Insights

THE VAT REVERSE CHARGE IS COMING SOON. SO WHAT ELSE IS NEW?

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SUMMARY

If the Brexit deal, ongoing Covid-19 developments and updates on the Building Safety Bill and the Corporate Insolvency and Governance Act isn't enough to keep those in the construction industry on their toes, the latest guidance from HMRC is that the VAT reverse charge on construction services will commence from 1 March 2021.

In our previous [blog on the VAT reverse charge in September 2019](#), we discussed what the VAT reverse charge is, why it is being introduced and the major effects it will have on how VAT is handled in the construction industry. The key message is that the reverse charge will require a recipient (the employer), rather than the supplier, of specified building and construction services to account for VAT. The new rule will apply unless the recipient is an "end user" or an "intermediary supplier" or is not required to report payment under the Construction Industry Scheme, in which case the normal VAT rules apply.

Following the postponement of the VAT reverse charge commencement date and the issue of [HMRC's VAT reverse charge technical guide in September 2020](#), we thought it was worth highlighting some of the key points.

New commencement date

All supplies made after 1 March 2021 will potentially be subject to the reverse charge, even if the underlying agreement was entered into prior to that date.

Employers should identify now whether the supplies that they are procuring will fall within the scope of the reverse charge, and, if so, ensure that any agreements they are entering into contain appropriate provisions to accommodate this.

Broad scope

The reverse charge will also apply to goods supplied with a single supply of construction services. However, it will not apply to transactions involving only the hire of goods.

Assumptions if “end user” or “intermediary supplier” status is not notified

Failure of recipients to notify suppliers in writing of their “end user” status will entitle suppliers to assume that the reverse charge applies.

Employers will need to assess whether they are an end user and, if so, ensure that they provide to suppliers written notification of their end user status. Our previous blog summarises the categories of end users in more detail, and explores some of the potential complexities and concerns with this requirement.

The normal VAT rules will apply not only to “end users” but also “intermediary suppliers” that buy construction services without making material alterations to the supplies, and then re-supply them to a connected or linked “end user”, who either:

- together with the intermediary supplier, has a relevant interest in the same land where the construction works are taking place (for example, a landlord and tenant); or
- is part of the same corporate group or undertaking of the intermediary supplier (as defined in section 1161 of the Companies Act 2006).

HMRC has confirmed in its September guidance that, if the above conditions are met, intermediary suppliers can include design and build companies that buy building and construction services from multiple suppliers (including services such as the supply of scaffolding) and provide these as a single supply to end user clients of the designed and built buildings.

In the same way as end users, intermediary suppliers need to provide written notification to suppliers of their status.

New “5% disregard” threshold for mixed supplies

HMRC’s guidance is not entirely clear, but it appears to set out the following policy.

If a supply includes services that are subject to the reverse charge, then all other services forming part of that supply will also be subject to it. However, the normal VAT rules will apply if the reverse charge element of the supply is 5% or less of the value of the whole supply (5% disregard). In this situation, the recipient should make an end user or intermediary supplier notification.

Employers should also be aware that at this stage the 5% disregard does not have legislative status. Employers wanting to rely on it may wish to notify HMRC in writing and keep clear and detailed records of how the 5% value of the supply has been calculated.

Reverse charge invoicing requirements

VAT invoices will need to include a statement that the VAT reverse charge applies. HMRC's latest guidance provides further detail on the particular invoicing requirements.

In circumstances where a recipient's VAT position changes partway through an invoicing period (such that there would be a single invoice including both reverse charge and normal VAT rules), HMRC has confirmed that the supplier may apply the new VAT treatment for that (applicable) entire invoicing period, or wait until the next invoicing period before changing to the new VAT treatment.

It follows that if the structure of a transaction changes during the life of the project, the parties must consider whether there are any consequential changes to the reverse charge position. Ideally, therefore, any agreements should be drafted at the outset to accommodate flexibility for such change.

Final thoughts, and some good news

While the delay in the reverse charge taking effect may have been partly driven by the construction industry lobbying that businesses were not prepared for this change (especially in view of the pandemic), there still seem to be some industry concerns that are not addressed in HMRC's latest guidance (some of which were highlighted in our [previous blog](#)).

On a positive note:

- We understand that the new JCT suite of standard form building contracts will contain additional provisions to address the VAT reverse charge regime. At this stage, the new suite is expected to be released in 2022.
- In the meantime, Practical Law Construction has published template contract clauses that address the mechanics around invoicing and accounting for the VAT reverse charge as well as specific requirements such as a prompt by the contractor to the employer to confirm its "end-user" status when issuing payment applications.
- HMRC guidance states that HMRC will apply a "light touch" in dealing with errors made in good faith during the first six months of the application of the reverse charge. Penalties will be considered in that period, only if the parties are "deliberately taking advantage of the measure by not accounting for [VAT] correctly".

We (still) fully expect innocent errors to be made during the initial application of the regime, as construction businesses continue to familiarise themselves with the latest rules and revisit their existing and new supply agreements, internal invoicing and accounting arrangements, and CIS and VAT registrations, in order to ensure compliance. Here's to hoping that any enforcement by HMRC during the initial period will indeed be light touch!

This [article](#) first appeared on the Practical Law Construction blog dated 10 February 2021.

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