

Reverse charge for construction services

(Lecture B1149 – 27.13 minutes)

Legislation

The Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019 brings in the reverse charge for construction services with effect from 1 October 2019. The final version of the law provides that the charge will only apply to supplies for which payment must be reported for construction industry scheme (CIS) purposes. The summary of the SI states that it acts to:

- apply a VAT reverse charge to construction services;
- define certain terms which appear in this Order;
- provide that the reverse charge will apply to services of a description specified in article 4 and that the supplies specified in article 8 are excepted from the reverse charge;
- specify construction services as being services to which the reverse charge applies;
- define construction services, specifying what services are and are not included within the term;
- provides for exceptions so that the reverse charge will only apply where construction services are supplied to other construction businesses;
- provide that certain exceptions may not apply where other construction services are being supplied by the same supplier to the same recipient in relation to the same construction site and those other services do not qualify as excepted supplies;
- make provision for supplies of construction services comprising a number of elements to be excepted from the reverse charge only when all of those elements would be excepted if separately supplied;
- provide that section 55A(3) of the Value Added Tax Act 1994 (which makes provision for reverse charge supplies to be treated as supplies made by the recipient for the purposes of VAT registration limits) shall not apply in relation to construction services as defined in this Order.

Under “Impact”, the Explanatory Note says the following:

The impact on business, charities or voluntary bodies is potentially significant for those supplying construction services because it is estimated that up to 150,000 businesses could be required to use it on supplies they make or receive. Only businesses that receive supplies where payments are reported through the Construction Industry Scheme will have to apply the reverse charge. In cases where a non-construction business falls within the scope of the Construction Industry Scheme because of the high value of its purchases of construction services, it may nevertheless come within the “end user” exception.

SI 2019/892

Reverse charge guidance

HMRC have updated their guidance on the Domestic Reverse Charge that will apply from 1 October 2019. This now makes a number of issues clearer than was the case with the previous version; it is obviously worth reading in detail for those directly affected, but the following extracts appear important.

Scope of the DRC

The reverse charge will affect supplies of building and construction services supplied at the standard or reduced rates that also need to be reported under CIS. These are called specified supplies.

There is an important difference between CIS and the reverse charge where materials are included within a service. The reverse charge applies to the whole service whereas CIS payments to net status sub-contractors are apportioned and no deductions are made on the materials content.

The reverse charge does not apply if the service is zero rated for VAT or if the customer is not registered for VAT in the UK.

It also does not apply to some services. These are those supplied to end users or intermediaries connected with end users.

Employment businesses who supply staff and who are responsible for paying the temporary workers they supply, are not subject to the reverse charge.

Supplies within the scope and outside the scope

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It also does not apply to some services. These are those supplied to end users or intermediaries connected with end users. Find out more found in the End users and intermediary supplier businesses section.

Employment businesses who supply staff and who are responsible for paying the temporary workers they supply, are not subject to the reverse charge. Read the Applying the domestic reverse charge for construction services to certain sectors or types of transactions section for more information.

You will have to apply the reverse charge if you supply any of these services:

- *constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services*
- *constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours*
- *pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence*
- *installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure*
- *internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration*
- *painting or decorating the inside or the external surfaces of any building or structure*
- *services which form an integral part of, or are part of the preparation or completion of the services described above - including site clearance, earth-moving, excavation, tunnelling and boring, laying of foundations, erection of scaffolding, site restoration, landscaping and the provision of roadways and other access works*

Services excluded from the domestic reverse charge

The following services are not subject to the reverse charge:

- *drilling for, or extracting, oil or natural gas*
- *extracting minerals (using underground or surface working) and tunnelling, boring, or construction of underground works, for this purpose*
- *manufacturing building or engineering components or equipment, materials, plant or machinery, or delivering any of these to site*
- *manufacturing components for heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems, or delivering any of these to site*
- *the professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants*

- *making, installing and repairing art works such as sculptures, murals and other items that are purely artistic*
- *signwriting and erecting, installing and repairing signboards and advertisements*
- *installing seating, blinds and shutters*
- *installing security systems, including burglar alarms, closed circuit television and public address systems*

Flowchart

There is a flowchart which goes through the logical process of deciding to apply the DRC:

1. *Does the supply fall within the scope of CIS? YES*
2. *Is the supply standard rated or reduced rated? YES*
3. *Is your customer VAT registered? YES*
4. *Is your customer registered for CIS? YES*
5. *Has your customer provided confirmation that it is an end user? NO*

DRC applies

“Light touch” for six months

The peculiar comment about “claiming end user status” that featured in the first version of the guidance notes has gone. Instead, the guidance now says:

HMRC officers may assess for errors during the light touch period, but penalties will only be considered if you are deliberately taking advantage of the measure by not accounting for it correctly.

Other matters

As a result of the reverse charge some businesses may find that, because they no longer pay the VAT on some of their sales to HMRC, they become repayment traders (their VAT Return is a net claim from HMRC instead of a net payment). Repayment traders can apply to move to monthly returns to speed up payments due from HMRC.

Supply with other elements

If any of the services in a supply chain are subject to the reverse charge, all other services (even if that service would be excluded if it were being supplied as a single service) will also be subject to it.

Supply and fix works will be subject to the reverse charge. For example, a joiner constructing a staircase offsite then installing it onsite is making a reverse charge service, even if the charge for installation is only a minor element of the overall charge.

In addition, if there has already been a reverse charge service between 2 parties on a construction site, and if both parties agree, any subsequent construction supplies on that site between the same parties can be treated as reverse charge services.

If there is doubt whether a type of works falls within the definition of a specified service, as long as the recipient is VAT registered and the payments are subject to CIS, the reverse charge should apply.

End users

The reverse charge does not apply to consumers or final customers of building and construction services. Any consumers or final customers who are registered for VAT and CIS will need to ensure their suppliers don't apply the reverse charge on services supplied to them.

For reverse charge purposes consumers and final customers are called end users. They are businesses, or groups of businesses, that do not make onward supplies of the building and construction services in question, but they are registered for CIS as mainstream or deemed contractors because they carry out construction operations, or because the value of their purchases of building and construction services exceeds the threshold for CIS.

Intermediary suppliers

Intermediary suppliers are VAT and CIS registered businesses that are connected or linked to *end users*.

To be connected or linked to an end user, intermediary suppliers must either:

- 1. share a relevant interest in the same land where the construction works are taking place*
- 2. be part of the same corporate group or undertaking as defined in s.1161 Companies Act 2006*

Reverse charge treatment of end users and intermediaries

The concept of intermediary suppliers means that if a number of connected businesses are collaborating together to purchase construction services, they are all treated as if they are end users and the reverse charge does not apply to their purchases.

For example, a property-owning group may buy construction services through one member of the group and recharge those services to either other group companies, their tenants or both. All the members of the property owning group and their tenants will be end users and the reverse charge should not apply.

Landlords, lessors, licensors, tenants, lessees or licensees and any persons 'connected' to them have a relevant interest in land. Having an agreement for lease is also a relevant interest in land. However, having a relevant interest in land does not include temporary rights to occupy land to carry out building and construction services.

You cannot choose whether you are an end user or an intermediary supplier because it is a matter of fact.

Asking suppliers about end user or intermediary status

You may not be sure whether you are supplying a customer who is an end user or intermediary supplier. In this situation, you should ask the customer if they are an end user or intermediary supplier and keep a record of the answer. It will be up to the customer to make the supplier aware that they are an end user or intermediary supplier and that VAT should be charged in the normal way instead of being subject to reverse charge. Sometimes it may be obvious that the customer is an end user, for example if there is a repeat contract, and it will be acceptable for you to charge VAT in the normal way.

Examples of end users include UK VAT registered mainstream or deemed contractors under CIS rules. With the exception of property developers, they are typically not construction businesses and are found in the retail, manufacturing, utilities and property investment sectors as well as public bodies.

Intermediary suppliers can call themselves end users in all communications which should be in writing (either digitally, or on paper). There is no set wording, but this is 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.'

If the reverse charge treatment depends on the customer's end user status and the treatment adopted is found to be incorrect (for example, because the customer is an end user but has not provided written confirmation resulting in the reverse charge being applied incorrectly) HMRC will expect the customer to notify the supplier that it is an end user and request a corrected invoice. In the case of self-billing, a new invoice will have to be issued and the VAT will have to be paid to the supplier.

Verifying the VAT status of customers

Before you can apply the reverse charge, you need to be satisfied that your customer is VAT registered. You can check that your customer's VAT number is valid and belongs to them on the European Commission website.

Verifying CIS registration of customers

You do not need to verify the CIS registration of existing customers if your contract is within CIS (but you should keep evidence of this where you have it, such as a deductions certificate as part of your VAT records).

You should ask new customers to provide details of their registration as a contractor for CIS purposes, or a copy of their CIS verification of you, and retain these.

However, if you are registered for CIS as a contractor HMRC recommends you use the CIS verification system. You will still be asked to confirm that you have placed an order with a sub-contractor before completing the verification, but for VAT purposes you can confirm this even though an order has not been placed by you.

There are also specific comments about contracts straddling the change in the rules, paperwork and entries on VAT returns, cash accounting and the flat rate scheme.

Reverse charge problem

There is a reverse charge on construction services in Hungary. In 2010 and 2011, a Hungarian company paid invoices from construction companies in connection with a motorway project. The suppliers charged VAT and the appellant deducted it. In 2015, the tax authority carried out an audit, assessed for tax of about €275,000, and added penalties and late payment charges.

The company's domestic appeal was based on an argument that the reverse charge should not have applied to the transactions. The company also claimed that the tax authority had denied them the right to deduct input tax, and had not considered the possibility that the suppliers had accounted for the output tax, resulting in potential double taxation. The tax authority ruled that the proper course was for the suppliers to correct their invoices to reflect the reverse charge.

The referring court asked whether the tax authority was obliged to investigate whether the supplier had accounted for the tax, and also whether the supplier was able to refund the output tax and claim it back from the tax authority. The questions referred to the principles of proportionality, fiscal neutrality and effectiveness, suggesting that the referring court was concerned that the tax authority had taken an unduly harsh line.

The CJEU took an equally hard line. It considered that the reverse charge regime imposed a "substantive requirement" for the right of deduction on the claimant – that the claimant must also account for the output tax that is to be claimed as input tax. As the appellant had not done so, it was not entitled to the deduction.

The Hungarian government had made representations to the court that there were domestic procedures for the customer to claim the overpaid VAT back from the supplier. The court noted that "if, in a situation where the VAT has actually been paid to the Treasury by the supplier of the services, the reimbursement of the VAT by the supplier to the recipient of the services is impossible or excessively difficult, in particular in the case of the insolvency of that supplier of services, the principle of effectiveness may require that the recipient of the services concerned be able to address its application for reimbursement to the tax authorities directly. In such a case, the Member States must provide for the instruments and the detailed procedural rules necessary to enable that recipient of services to recover the unduly invoiced tax in order to respect the principle of effectiveness."

The appellant had argued before the court that one of the suppliers was insolvent. The court suggested that this would be a circumstance that would make correction of the situation impossible or excessively difficult. If that was the case, and it was established that the supplier had accounted for the output tax to the authorities, the appellant would have a claim for direct reimbursement of the overpaid VAT. However, that was a matter quite separate from the point at issue: the claim for input tax was incorrect, because it should have been dealt with under the reverse charge procedure.

The tax authorities were under no obligation to check the supplier's position before disallowing the claim to input tax, and a direct claim for reimbursement would be a subsequent procedure for the appellant to enter into, subject to different rules.

CJEU (Case C-691/17): PORR ÉpítésiKft v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága

Article: Taxation 17 January 2019

In an article in *Taxation*, Neil Warren points out a significant side-effect of the new reverse charge for the construction industry for small businesses. Because reverse charge supplies are excluded from the FRS, a construction business using the FRS will not have to account for any VAT on such supplies to HMRC; but it will also not collect any VAT from its customers, and will still not be entitled to deduct any input tax on its costs. It will therefore lose the benefit of using the FRS in relation to that part of its business that is subject to the reverse charge, and should consider whether the FRS remains beneficial after 1 October 2019.

Article: Taxation 24 January 2019

In an article about the Finance Bill debates in *Taxation*, Richard Curtis noted debate about the detailed rules on the effect of reverse charge supplies on registration liability. What is now FA 2019 s.51 inserts a new ss.(9A) into VATA 1994 s.55A, providing that “An order made under subsection (9) may modify the application of subsection (3) in relation to any description of goods or services specified in the order.” S.55A(3) provides that reverse charge supplies count for registration liability purposes. There appeared to be a concern that more small builders would be made registrable by the new rules because their costs would be added to their outputs in determining whether they had exceeded the threshold, but the government minister responded that the provision would allow an order preventing this unintended effect. This demonstrates how many complicated and often unpredictable consequences may arise from such a change.

Contributed by Mike Thexton