



The Construction Industry Scheme (CIS) VAT reverse charge applies to construction services from 1 October 2019

HMRC are introducing a major change to VAT in the construction industry.

Essentially subcontractors will still be VAT registered and will bill for their work, the contractor (or customer) will not pay over the VAT. The contractor will include the VAT in their VAT return as an input and an output.

When businesses fail, it is often the case that they owe taxes. All business that charge and collect VAT are essentially unpaid tax collectors for the government. Therefore, if the subcontractors receive the VAT, are having cash flow problems and do not pay it over, it is the government that loses, as it was not their cash in the first place. This new legislation stops the contractors being in receipt of the VAT in the first place, thereby eliminating this aspect.

It is also hoped it will reduce fraud generally.

The CIS VAT reverse charge applies to sales of construction work from 1 October 2019.

- When the reverse charge applies the customer accounts for the supplier's output VAT. The subcontractor will only receive net pay, and no VAT.
- It only applies to construction supplies made by business to business.

Key conditions:

Apply the reverse charge when all the following are met:

- The supply for VAT consists of construction services and materials.
- It is made at a standard or reduced-rate of VAT.
- Between a UK VAT registered supplier and UK VAT registered customer.
- Supplier and customer are registered for CIS.
- The customer intends to make an ongoing supply of construction services to another party.
- The supplier and customer are not connected.

What services are within the CIS reverse charge?

- 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

Excluded services

- 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

Certain services can become included:

- If there is reverse charge element in a supply then the whole supply will be subject to the domestic reverse charge.
- If there has already been a reverse charge service between two 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.
- The contractor is asked to consider all construction contracts with a sub-contractor. If they can see that reverse charge applies to more than 5% of contracts (by volume or value) with that sub-contractor, then the reverse charge may be applied to all the contracts.

HMRC 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.

Accounting Treatment

The VAT treatment is determined for payments due on any supplies entered into your accounting system before 1 October 2019, but paid on or after 1 October 2019.

Date entered in customer's accounting system	Date payment made	VAT Treatment
Before 1 Oct 2019	On or before 31 Dec 2019	Normal VAT rules
Before 1 Oct 2019	On or after 1 January 2020	Domestic reverse charge
On or after 1 Oct 2019	On or after 1 Oct 2019	Domestic reverse charge

Planning points

The reverse charge will require a significant change of approach in many CIS businesses:

- Staff will need to be properly trained to identify relevant CIS contracts and End Users.
- Documentation needs to be created to certify End Users.
- Staff will need to be clear on what rate of VAT is applicable with or without the charge.
- Accounting and bookkeeping systems will need to be modified to cope with the new invoicing and reporting obligations.
- Cash flow will be affected for subcontractors and those at the start of the supply chain may become VAT repayment claimants: they need to consider whether to file monthly returns. (this may be useful advise to our subcontractors)

The CIS reverse charge does not apply to any of the following supplies:

- Supplies of VAT exempt building and construction services.
- Supplies that are not covered by the CIS, unless linked to such a supply.
- Supplies of staff or workers.

Example: how the CIS reverse charge works

John the Roofer (who is VAT registered) supplies the materials and roofs a new office building for Contractor who (is also VAT registered) and in turn supplies its construction services to Developer (also VAT registered). Developer finds and develops land and will in this case, bring the build to completion and supply a finished commercial building to End-user, its client.

- John the Roofer would under the old VAT system, invoice Contractor £120,000, comprising of his £100,000 bill for materials, labour and works, plus £20,000 in VAT (at 20%).
- From October 2019, under the new CIS reverse charge mechanism, he invoices £100,000. His invoice states that "the CIS reverse charge applies" (see invoicing requirements in *Overview*) and that the applicable rate of VAT is 20%.
- Contractor pays John the net £100,000 fee. It then accounts for output and input VAT of £20,000 on the supply on its own VAT return.
- John does not account for output VAT in his accounting system as he has invoiced only his fee £100,000.
- As a consequence of the reverse charge procedure, John charges and receives £20,000 less than under the old system (where he would charge £100,000 + VAT) however he does not have to account to HMRC for any output tax on the transaction.
- When he is paid he includes the value of the sale in box 6 of his VAT Return. He does not add VAT to box 1 as he receives no output VAT.

- The change may well impact John's cash flow, as under the old rules, if Contractor was a prompt payer he could hope that he could use the £20,000 in VAT to purchase his materials. He could then purchase his materials and offset the input tax paid against his output liability.
- Contractor has a cash flow advantage, it does not have to pay John £20,000 and then at the end of its VAT quarter it cannot reclaim £20,000 as it is accounting for the reverse charge and the output VAT offsets the input VAT.
- As Contractor is supplying CIS services it must also consider the reverse charge. Will its client (Developer) going to be involved in the onward supply of CIS services? In this case, this may be difficult to determine as apparently Developer is selling a finished building to End-user is an investor and the reverse charge does not apply. It is Developer's responsibility to notify down the supply chain.

Invoices

When supplying a service subject to the CIS reverse charge, suppliers must show all the information that is normally required on a VAT invoice, except that:

- A note on the invoice must make clear that the CIS reverse charge applies and that the customer is required to account for the VAT.
- No VAT is charged on the invoice.
- It should state how much VAT is due under the reverse charge, or the rate of VAT if the VAT amount cannot be shown, but that VAT should not be included in the amount charged to the customer

Under the VAT Regulations 1995 invoices for services subject to the reverse charge where the customer is liable for the VAT must include the reference 'reverse charge'. Here are some examples of wording that meet the legal requirement:

- reverse charge: VAT Act 1994 Section 55A applies
- reverse charge: S55A VATA 94 applies
- reverse charge: Customer to pay the VAT to HMRC

VAT penalties

- Some businesses are going to have a certain amount of 'teething problems' in getting to grips with the reverse charge mechanism.
- HMRC's guidance currently states
- 'HMRC understands that implementing the reverse charge may cause some difficulties and will apply a light touch in dealing with any errors made in the first 6 months of the new legislation, as long as you are trying to comply with the new legislation and have acted in good faith.
- Any errors need be corrected as soon as possible, as the longer under declared or overcharged sums remain outstanding the more difficult it may be to correct or recover them.
- 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.'

HMRC full guide is here which includes a flowchart example:

<https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services>