

JULY 2019

BUSINESS UPDATE

VAT: New Accounting Procedures for Builders - 1 October 2019

You might have read that new procedures are being introduced on 1 October 2019 which affect any VAT registered construction business that does the following:

- ▲ Buys in construction services from other builders and makes an onward supply of those services to another customer e.g. where a subcontractor invoices the main contractor on a project and the main contractor invoices the final 'end user' client.
- ▲ Sells construction services to other builders where the builders make an onward supply of the services to their customer.

What is changing?

Under current rules a builder charges VAT to their customer, collects the VAT from the customer and accounts for it in Box 1 of their relevant VAT Return.

This is changing for supplies between VAT registered builders reported under the Construction Industry Scheme (CIS). The builder will invoice their customer without charging VAT and the builder customer makes the Box 1 entry instead on their own VAT Return.

In effect, there will be no cash flow issue for the customer receiving services because the same amount of VAT declared in Box 1 will also be included as input tax in Box 4 i.e. a nil effect overall. This is known in VAT speak as a "reverse charge" procedure.

However builders providing services to other builders that rely on VAT collected from their customers as working capital until they have to pay it to HMRC are likely to have a cash flow issue because they may no longer receive VAT on some of their sales.

Builders affected may wish to move to monthly VAT Returns to improve their cash flow if they become repayment traders (their VAT Return is a net claim from HMRC instead of a net payment).

Reason for change

HMRC has identified that certain builder supplies have been prone to VAT fraud, where the supplier charges VAT to his customer, receives money for this VAT from the customer but never declares it on a VAT Return. The new procedures aim to prevent this from happening because the supplier is never paid VAT in the first place.

Which sales are caught by the new rules?

The new reverse charge procedures will apply to the following transactions:

- ▲ Services reported under the CIS referred to the legislation as 'specified services' but these do not apply to services supplied to non construction businesses such as a

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retailer having their premises improved or any other end user customer or building owner;

- ▲ The reverse charge will also apply to any goods supplied by the builder as part of their work;
- ▲ Employment businesses are excluded from the new rules;
- ▲ The reverse charge is based on the rate of VAT that applies for the work in question but only supplies subject to either 5% or 20% VAT. Zero rated sales are excluded.

Example

Mike is an electrician, VAT registered as a sole trader. He is doing some work on an office block, invoicing the main contractor Steve for his work.

Steve is also VAT registered and will then invoice the building owner. Steve is not an “end-user” because he is making an onward supply of construction services to his own customer. He is an “intermediary supplier”.

The invoice raised by Mike will be subject to the new procedures i.e. no VAT is charged. Let’s say the value of his work including materials will be for £5,000:

Mike’s VAT Return will only include the value of the sale in Box 6 (outputs) of his VAT Return:

Box 6 – outputs - £5,000

Steve will do the reverse charge calculation and make the following entries on his Return:

- *Box 1 – output tax £1,000 (i.e. £5,000 x 20%)*
- *Box 4 – input tax - £1,000 (same figure as Box 1)*
- *Box 7 – inputs - £5,000 (net value of payment made to Steve)*

Other issues to consider

Taking the Steve and Mike example a stage further, they each have their own responsibilities with the new rules.

Mike must ensure that Steve is both registered for the CIS and also has a valid VAT number.

Mike must also specify on his sales invoices the amount and rate of VAT that Steve must declare with the reverse charge i.e. 5% or 20% VAT.

Mike should include wording on the sales invoice along the lines of: “Reverse charge: Customer to pay the VAT to HMRC.”

Steve must tell Mike if he is an “end user” or “intermediary supplier”. If he is an intermediary supplier then Mike will not charge him VAT because the reverse charge applies.

It is important that Steve does not pay VAT incorrectly to Mike because HMRC could raise an assessment for the VAT that he should have declared i.e. as if the reverse charge had been done correctly.



Here are a few other points to consider:

- ▲ Checks should be applied to ensure building contractor clients invoiced under the new rules are properly registered for VAT and are bona fide. Section 9 of HMRC VAT Notice 735: Domestic reverse charge procedure gives further information.
- ▲ HMRC suggests that if there are any doubts about the credentials of a builder customer, then a deposit equal to the amount of VAT not being charged should be collected from the customer e.g. if they have applied for but not received a VAT number.
- ▲ VAT Notice 735 mentioned above gives examples of customer checks that should be considered at para 9.3.1

Penalties issued by HMRC for errors

HMRC has confirmed that penalties will not be charged for mistakes with the new procedures up until 31 March 2020, the exception being if “you are deliberately taking advantage of the measure by not accounting for it correctly”.

What you need to do to be ready

The latest HMRC guidance encourages traders to:

- ▲ Check whether the reverse charge affects either sales, purchases or both;
- ▲ Make sure accounting systems and software are updated to deal with the reverse charge;
- ▲ Consider whether the change will have an impact on cash flow; and
- ▲ Make sure all staff who are responsible for VAT accounting are familiar with the reverse charge and how it will operate.
- ▲ Contractors should review all contracts with subcontractors to decide if the reverse charge will apply and notify your suppliers if it will.
- ▲ Subcontractors should contact customers to get confirmation from them if the reverse charge will apply, including confirming if the customer is an end user or intermediary supplier.

Summary

We hope this Business Update gives you an idea about the key issues to consider with the new rules. Please get in contact if you have any questions.
