

The Domestic Reverse Charge

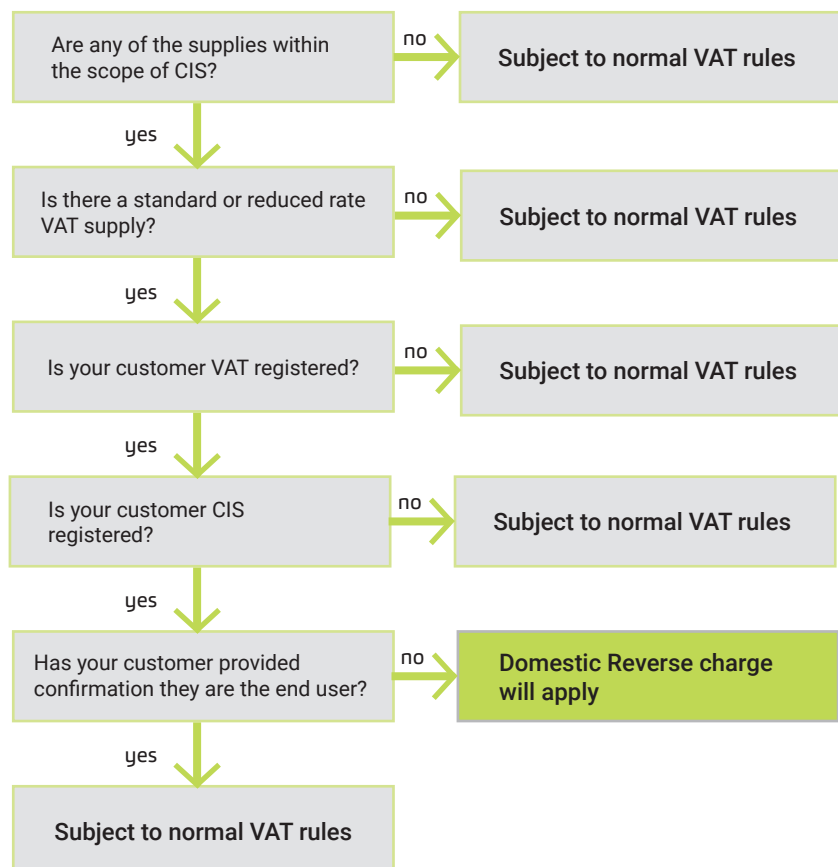
The Domestic Reverse Charge for building and construction services.

The Domestic Reverse Charge (“DRC”) comes into effect on 1 March 2021, changing the way VAT is collected in the building and construction industry.

The DRC will make the VAT registered customer responsible for accounting for VAT due on affected supplies, rather than the supplier.

Please follow the flow diagram to see if your supplies fall under the domestic reverse charge for building and construction services.

This is a mandatory charge. It is not optional.



Who will it apply to?

The DRC will only apply to you if you are VAT registered in the UK and you either receive or supply services within the scope of the Construction Industry Scheme (CIS). This only applies in respect of supplies between VAT registered contractors, it does not apply to the 'end user' customers (e.g. home owners).

The DRC only applies to standard rated and reduced rated supplies. Zero rated supplies will continue to be dealt with under the current system.

What will it apply to?

The DRC will apply to construction services generally. The full list is detailed and comprehensive, but includes:

- General construction;
- New building works;
- Groundworks, including excavation and earth moving;
- Renovations and maintenance services;
- Internal cleaning of buildings (carried out in the course of construction, extension etc.);
- Painting and decorating of buildings and structures.

What won't it apply to?

- Drilling for, or extracting of oil, natural gas and minerals;
- Manufacturing building or engineering components or delivering to site;
- The professional work of architects, surveyors, engineers and consultants;
- Installing seating, blinds, shutters and security systems, including burglar alarms, closed circuit television and public address systems;

How will it work?

If you make supplies falling under the reverse charge procedure you will be required to issue an invoice stating that the service is subject to the domestic reverse charge and that the customer is required to account for the VAT.

The customer can recover that VAT amount as input tax (subject to the normal rules), this would normally mean a nil net tax position with no VAT being due to HMRC.

Equally, if you receive supplies within the DRC you will need to account for the VAT due as set out above.

Other common questions and answers

Q. Does the Domestic Reverse Charge count towards my turnover for when I must register for VAT?

A. No. Your turnover is calculated in the normal way, on the supplies you make.

Q. When does the Domestic Reverse Charge start?

A. It starts on 1 March 2021. In practice, this means, if you raise an invoice on or after 1 March 2021 then you should apply the reverse charge. If you raise an invoice before that date, you should use the current system. If a construction project spans this date it could mean you will have to use both systems to account for VAT.

Q. Does it apply to all rates of VAT?

A. It only applies to standard and reduced rate supplies. It does not apply to zero-rated supplies, but care must be taken if you have mixed supplies.

Q. How do I raise an invoice if only some of my supplies fall under the reverse charge?

A. It will be necessary to apportion your supplies.

Q. How will my cashflow be affected?

A. Your cashflow may improve if you are a contractor because you will not be paying the VAT element of your sub-contractor's invoice. Instead, you simply net off the VAT in your VAT return.

If you are a sub-contractor, you will no longer have the benefit of receiving your customers' output VAT in advance of paying HMRC and this may cause cashflow issues. You may start to receive payments from HMRC because you've become a repayment trader. If this is the case, you could choose to submit monthly VAT returns to speed up repayments. To change to monthly VAT returns you will need to advise HMRC. You should do this prior to the start of the Domestic Reverse Charge start date.

Q. Can I use the Cash Accounting Scheme under the reverse charge?

A. No. You can't use the Cash Accounting Scheme for reverse charge supplies. This will have an impact on how you manage your accounts but should not affect cashflow because you can simultaneously reclaim any VAT you have to pay. You will need to adjust your accounting method prior to making any Domestic Reverse Charge supplies.

Q. Can I use the Flat-rate Scheme?

A. No. Supplies that fall under the reverse charge cannot be accounted for under the flat-rate scheme.

Q. How should Authenticated Receipts and Self-Billing be treated?

A. Authenticated tax receipts and self-billing invoices should contain all the information that a standard reverse charge invoice does but additionally state:

- Reverse charge: we will account for and pay the output tax due to HMRC or;
- Reverse charge: as the UK Customer we will pay the VAT due to HMRC.

Q. How do I charge for building materials I supply?

A. If you supply building materials with labour it will all be subject to the reverse charge. If you supply materials without installation you will need to account for VAT in the normal way.

Q. If I get it wrong will HMRC penalise me?

A. HMRC have said they will apply a 'light touch' for any errors in the first six months where businesses are genuinely trying to comply.

Q. Do I need to complete additional submissions to HMRC?

A. No. You are only required to complete your VAT return.

Q. Will Brexit affect it?

A. No. This is a domestic VAT rule. It only applies in the UK.

Q. How do I check if a business is VAT or CIS registered?

A. In the first instance, ask them. Additionally, you can use the CIS Verification system for VAT you can use the European Commission's website which has a VIES VAT number validation checking system.

Q. How do I treat credit notes?

A. If both you and the supplier of the credit note agree; you don't have to amend the original VAT charge. Otherwise, you should follow the adjustment below:

Supplier of Domestic Reverse Charge services:

- Issues the customer with a Domestic Reverse Charge credit note stating: *Reverse charge: Customer to account for Output tax adjustment of £X.XX to HMRC.*
- Enters the net value of sales in Box 6 of their VAT return.

Customer of Domestic Reverse Charge services:

- Enters the VAT amount in Box 1, Box 4.
- Enters the net value of sales in Box 7 of their VAT return.

How to complete your VAT return

For sales: do not complete box 1 of your VAT return but enter the net sales figure in box 6.

For purchases: if you have purchased a service subject to the reverse charge you will need to enter the VAT amount in Box 1 of your VAT return. You can also reclaim it (subject to the normal rules) in Box 4 of your return. Do not enter the net sales in your Box 6 of the VAT return but enter the net purchase amount in Box 7.

Supplier of Domestic Reverse Charge services

- Issues the customer with a Domestic Reverse Charge sales invoice stating: *"This service is subject to the reverse charge"*.
- Enters the net value of sales in Box 6 of their VAT return.

Customer of Domestic Reverse Charge services

- Enters the VAT amount in Box 1, Box 4
- Enters the net amount in Box 7 of their VAT return.

An invoice subject to the domestic reverse charge should contain the following information:

- All the information required on a normal VAT invoice;
- 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.

It should also contain a note to make it clear that the domestic reverse charge applies and that the customer is required to account for the VAT.

These 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

If your system cannot show the amount of VAT to be accounted for under the reverse charge, then the wording should state that VAT is to be accounted for by your customer at the standard or reduced rate of VAT, based on the VAT-exclusive selling price for the reverse charge goods or services.

Want to find out more?

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