

WATSON FARLEY & WILLIAMS

BRIEFING

VAT REVERSE CHARGE FOR CONSTRUCTION SERVICES FROM 1 OCTOBER 2019 AUGUST 2018

- FROM 1 OCTOBER 2019, A VAT REVERSE CHARGE WILL APPLY TO BUSINESS-TO-BUSINESS SUPPLIES OF CERTAIN CONSTRUCTION SERVICES
- THIS IS AN ANTI-FRAUD MEASURE ON WHICH HMRC HAS CONSULTED
- HMRC EXPECTS THE COMPLIANCE BURDEN TO BE SIGNIFICANT SO SMALL BUSINESSES IN PARTICULAR SHOULD START THINKING ABOUT PREPARING NOW



If you are a developer or main contractor engaging other construction professionals, you should be aware that HM Revenue & Customs (“HMRC”) has consulted on a draft order to introduce, from 1 October 2019, a VAT “reverse charge” for business-to-business supplies of certain construction services (other than the professional work of architects or surveyors, or of consultants in construction services). The reverse charge is an anti-fraud measure that will require the recipient of those supplies to pay the VAT on those supplies directly to HMRC instead of to the supplier. HMRC will publish a final version of the order and guidance by October 2018.

“HMRC HAS IDENTIFIED THE CONSTRUCTION INDUSTRY AS ONE IN WHICH IT IS DIFFICULT TO COLLECT THE RIGHT AMOUNT OF TAX FROM A LARGE, HIGHLY MOBILE WORKFORCE.”

While the reverse charge is over a year away, as a developer or main contractor, you should start preparing for it now. In particular, it may be helpful to familiarise yourself with the new rules so that you can determine whether to adapt accounting systems and processes to enable reverse charge supplies to be calculated and reported. Thankfully, HMRC acknowledges the compliance burden so support will be available during the one year lead-in period. You may also be relieved to know that HMRC has indicated that, for the first six months after the reverse charge takes effect, it will adopt a “light touch” approach to genuine mistakes and related penalties.

Why have a reverse charge?

HMRC has identified the construction industry as one in which it is difficult to collect the right amount of tax from a large, highly mobile workforce. For direct tax compliance, you are likely to be familiar with the Construction Industry Scheme

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“CIS”). Under the CIS, payers deduct tax from certain payments relating to construction work and account for that tax to HMRC. The CIS allows payers to make payments relating to construction work without deduction in certain circumstances.

In relation to VAT, however, labour-only suppliers in the sector do not incur significant VAT on their costs. In turn, they can charge VAT to their customers, such as developers or main contractors; and, if they “go missing”, could fraudulently keep that VAT for themselves. This is commonly known as “missing trader” fraud.

The reverse charge makes missing trader fraud impossible because the customer (i.e. the developer or main contractor), rather than the supplier (the trader who subsequently goes missing), accounts for the VAT directly to HMRC. The reverse charge already exists to combat missing trader fraud in supplies of, for example, emissions allowances and gas and electricity.

How will the construction services reverse charge work?

If you are a VAT registered business (the “recipient”) receiving a supply of “specified services” (that are not “excepted supplies”) from another VAT registered business (the “supplier”) on or after 1 October 2019, you will have to account for that VAT to HMRC instead of paying the VAT to that supplier. “Specified services” are “construction services” (based on the CIS definition) together with any goods supplied with those services that are treated as part of a single supply of services.

“Construction services” are broadly defined and include:

- constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installations;
- constructing, altering, repairing, extending or demolishing any works forming, or to form, part of the land, including roadworks, power-lines, electronic communications apparatus, docks and harbours, railways and pipe-lines;
- installing in any building or structure systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection;
- internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration; and
- painting or decorating any building or structure.

Unless they form part of a single supply that includes services described above, the following (among others) are not “construction services”:

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

“...FOR SIX MONTHS AFTER THE REVERSE CHARGE COMES INTO EFFECT, HMRC WILL TAKE A “LIGHT TOUCH” APPROACH TO GENUINE MISTAKES AND RELATED PENALTIES.”

The exception for architects, surveyors and consultants is a useful one but one should note HMRC’s guidance¹ on how that exception applies (in the context of the CIS). If architects go beyond providing a building design and undertake project management, the exclusion may no longer apply. For surveyors, the exclusion aims to cover their traditional functions, namely surveying land and inspecting properties. However, if the “survey” goes beyond inspection and includes, for example, carrying out remedial work, the exclusion no longer applies. For other professionals, the exclusion will only apply to those whose services are consultative, i.e. separate from executing or managing construction work.

“Excepted supplies” (i.e. those to which the reverse charge will not apply) are supplies of specified services (as defined above):

- to recipients that are not themselves construction businesses;
- to landlords who makes onward supplies of those services to tenants that are not construction businesses; and
- to a recipient who uses those services to make further supplies of specified services to a member of its corporate group that is not a construction business.

Practical implications of the reverse charge

In practice, a developer or main contractor receiving construction services from a third party supplier will have to account for the VAT through its VAT return instead of paying the VAT to the supplier. In turn, the developer or main contractor will be able to reclaim that VAT as input tax (subject to the normal rules). The supplier will have to issue a VAT invoice that indicates that the supplies are subject to the reverse charge. That all seems simple enough and the move to a reverse charge system should not create a permanent VAT cost that does not currently exist.

That said, compliance with the new rules will require adapting accounting systems and processes to enable reverse charge supplies to be calculated and reported. Further, you will need to keep records of reverse charge supplies. HMRC states² that support, including guidance, will be available during the year leading up to the reverse charge’s entry into force. However, small business in particular can take comfort from the fact that, for six months after the reverse charge comes into effect, HMRC will take a “light touch” approach to genuine mistakes and related penalties. While the reverse charge is over a year away, we would suggest that you think about preparing for it now.

¹ Construction Industry Scheme Reform Manual, paragraph CISR14270 (3 August 2016).

² Draft tax information and impact note: VAT reverse charge for construction services.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.



TOM JARVIS
Partner
London

+44 20 7863 8917
tjarvis@wfw.com



DAVID JACOB
Senior Associate
London

+44 20 3314 6439
djacob@wfw.com

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