

CIS & VAT

Domestic Reverse Charge Legislation

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INTRODUCTION

From 1 March 2021, those businesses which are VAT registered and whose payments are reported via the Construction Industry Scheme, will be subject to the CIS/VAT domestic reverse charge legislation.

This new legislation only applies if both the contractor and subcontractor are VAT registered, regardless of whether the contractor/subcontractor has gross status. This is because the domestic reverse charge is based on whether supplies are CIS specified, not on the CIS status of the contractor/subcontractor.

HMRC has implemented this procedure to combat missing trader fraud, which is prevalent across several industries.

As HMRC has implemented such procedures to combat this problem across other industries, it has now found its way within the construction industry.

Essentially, missing trader fraud, is a simplified version of 'carousel fraud' (the exploitation of importing VAT free goods from one country, then selling to several other companies)

However, whereas carousel fraud is an international problem, missing trader fraud is a UK one.

Usually, subcontractors charge 20% VAT on their invoices, which is then paid back to HMRC. No problem there, but as the service advances up the hierarchy, VAT is added onto each new transaction, enabling contractors to claw back the VAT paid to their subcontractors.

The new legislation impacts on both subcontractors and contractors, which is explained in full below.

A key point to note, is that subcontractors will be affected. They will suffer a cash flow implication, due to the VAT not being paid to them

Contractors will benefit from the new legislation, as they are no longer required to pay VAT to subcontractors

WHEN A BUSINESS IS BOTH A CONTRACTOR AND SUBCONTRACTOR

When working as a contractor, the regulations for contractors must be adhered to.

When working as a subcontractor, the regulations for subcontractors must be adhered to.

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INVOICING

At this point in time, invoices are raised as shown below -

| | |
|---------------------|------------|
| Labour | 300 |
| Materials | 100 |
| Sub total | 400 |
| VAT @ 20% | 80 |
| Less CIS @20% | 60 |
| Total to pay | 420 |

Table 1 – Usual invoice

From 1 March 2021, although invoices will still show all the usual information, they must also:

1. Very clearly state that the domestic reverse charge applies, and the contractor is required to account for the VAT element
2. Ensure that the VAT is not included within the total to pay
3. Whereas, CIS is only deducted from the net labour element (providing that materials, hire of equipment, fuel etc, are written on separate lines), the domestic reverse charge, applies to the whole invoice

Table 2 - Invoices dated from 1 March 2021

The example below fulfils the new legal requirement -

| | |
|---------------------|------------|
| Labour | 300 |
| Materials | 100 |
| Sub total | 400 |
| VAT @ 20% | 0 |
| Less CIS @ 20% | 60 |
| Total to pay | 340 |

Domestic reverse charge: Contractor to account for the VAT of £80 to HMRC

PLEASE NOTE -

Normal VAT rules will apply in regards to invoices dated before 1 March 2021, which are paid on or before 31 May 2021.

The domestic reverse charge will apply to invoices dated before 1 March 2021, which are paid on or after 1 June 2021.

The VAT payable by the subcontractor, is accounted for via the contractor's VAT return. This is done by accounting for the VAT, as both VAT on sales, and purchases on the return. Therefore, there is a nil impact on the resultant VAT liability (Please see page 9)

If you use accounting software to raise invoices, the easiest way to ensure that VAT is not included in the invoice, is to change the sales default settings to zero rated VAT. This will ensure that no VAT is added onto the invoice, but the net sales should still appear on the VAT return (More about VAT returns further on)

So, using table 2 –

1. Subcontractors £300 zero rated VAT
2. Materials £100 zero rated VAT

(As the CIS element is entered as a credit, and is zero rated, this will already appear on the VAT return)

Contractors – If you still receive invoices under the old system dated 1 March 2021 onwards (Table1), and have not received notification of end user status (see page 5), then please ensure that the VAT amount is not paid, and treat as the domestic reverse charge on your VAT return, as explained on page 9.

If there are CIS related supplies and exempt supplies written on the same invoice, the domestic reverse charge will apply to the whole invoice.

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EXEMPTIONS

END USERS

End users are individuals/businesses who receive construction/building services, but do not pass these on (even if they have to report payments via CIS).

A few examples of end users are:

1. Work completed at an individual's place of residence
2. Large retailers who spend a significant amount of money on an annual basis on construction services, but uses the properties for their own retail business.

Please note – If individuals/businesses state that they are end users, when in fact they are not, HMRC will levy penalties, so if in doubt, always apply the domestic reverse charge.

LOCAL AUTHORITIES AND PUBLIC BODIES

The end user exemption will usually apply to supplies to public bodies. Most supplies will either be related to the public body's property or land, or provided to the public body, so it can discharge its responsibilities under a special legal regime.

If the public body is acting on a commercial basis, and selling on the construction service, the end user exemption will not apply. The public body will have to account for the VAT to HMRC. It will also have to establish the end user status of its customer.

INTERMEDIARY SUPPLIERS

These are VAT registered businesses who are connected or linked to end users -

Supplies of construction services between group companies-

The exemption will only apply when the customer is an end user, and the supplier is part of that customer's corporate group.

Supplies of construction services between landlords and tenants

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IMPORTANT NOTE

It is the above's responsibility, to inform the supplier or building contractor of their end user status. The supplier or building contractor must be informed of this in writing,(by either email or via post) and it is very strongly recommended that this is kept for future reference.

An example of the wording to use is:

'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 normal VAT invoice, with VAT charged at the appropriate rate. We will not account for the reverse charge.'

Once notification has been received, there is no requirement to reissue it, providing there are no changes to the end user status. All end users must inform the supplier or building contractor of their status (as explained above), regardless of whether they are an individual, insurance company, a local authority or other public body etc., or classed as an intermediary supplier, otherwise the domestic reverse charge will apply.

It is very important that the person writing the above notification knows and understands that it is correct – If it is incorrect, the customer will be liable for accounting for the VAT that should have been charged under the domestic reverse charge. If the preparation and/or submission of your VAT return is outsourced to a third party (such as your accountant), please ensure that the notification of end user status, is forwarded on.

If an end user does not inform you of their end user status, then the domestic reverse charge must be applied (please see page 7).

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CHOICE TO IMPLEMENT THE REVERSE CHARGE

When the rules were originally legislated, end users, connected parties, landlords and tenants were automatically exempt from the VAT domestic charge, but this meant that the supplier had to check the status of the customer.

However, the rules were revised in July 2020 and the exemption will only apply if the customer notifies the supplier or building contractor in writing that the exemption applies (See page 6, important note).

Essentially, this gives end users, and other customers who may be able to claim the exemption, the choice whether to apply the domestic reverse charge or not. Therefore, customers who are end users, will need to consider whether they want to notify the supplier or building contractor that the exemption applies

As there could be cash flow benefits, some customers may prefer the domestic reverse charge to apply.

VAT SCHEMES

Cash accounting

When supplies of services are subject to the domestic reverse charge, this scheme cannot be used.

Accounting for payments made and received

Some businesses prefer to account for their VAT, on the basis of when payments were made or received.

Sales – When the supply is covered by the domestic reverse charge, no VAT will be due from customers. Please see page 9 as this will explain how to account for this in the VAT return.

When supplies are provided to those exempt from the domestic reverse charge (please see page 5), VAT must be accounted for, on the date payment was received.

Purchases – Please see page 9, as this will explain how to account for the domestic reverse charge applied to services received from subcontractors, on the VAT return.

Flat rate scheme

Under this scheme, those that receive domestic reverse charge supplies, will have to account for the VAT due to HMRC. Please see page 9, as this will explain how to account for this in the VAT return.

Bearing in mind that VAT cannot be reclaimed on materials, overheads etc., users should consider whether it would still be beneficial to them to remain on the scheme.

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VAT RETURNS

Suppliers (Subcontractors)

1. Do not enter any VAT in box 1 on sales for which the domestic reverse charge applies
2. Enter the value of such sales in box 6 (Using table 2, the figure entered is £400).

Please note: If you changed the settings to zero rated VAT, as advised on page 4, this should automatically be done. However, please check before submitting your VAT return.

Customers (Contractors)

1. In box 1, enter the VAT on purchases for which the domestic reverse charge applies (Using table 2, this would be £80).
2. Do not enter net purchases in box 6.
3. Reclaim the VAT on the purchases/labour, by entering the VAT in box 4 (Same as point 1), as usual.
4. Enter the net value of such purchases/labour in box 7 (Using table 2, this would be £400).

(As the CIS element is entered on your system as a credit note, and is zero rated, this will already appear on the VAT return).

As seen, although the VAT element is entered in box 1, because it is also entered in box 4, they cancel out one another.

Please note - If a subcontractor raises an invoice which only states materials, hire of equipment etc., then this is dealt with in the usual way

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SOFTWARE

Your software provider should provide an update which will allow you to deal with the domestic reverse charge in a relatively straightforward manner.

Unfortunately, we are unable to provide anymore information on this as it will be dependent on each software provider. If you want any more information on this, it is recommended that you contact your software provider. If your software is not updated, it is recommended that you proceed in the following way –

Sales

1. If your sales invoices are raised using your software, please ensure that you follow the procedure, as already advised on page 4.

2. If your sales invoices are raised manually, enter the net sales figure, for which the domestic charge applies, and change the VAT rate to zero rated.

Labour/purchases

1. Enter the net amount of the invoice, ensuring that labour, materials, hire of equipment etc., are entered individually, and on each change the VAT rate to zero rated.

2. On a spreadsheet, enter the date of the invoice, supplier name, invoice number and the VAT element.

3. At the end of each VAT quarter, total these amounts.

4. Enter this total as an adjustment, on your VAT return, as explained on page 6.

(There should be an option on your software, to enter these adjustments. If not, or if you require any help with this, please contact your software provider)



CONTACT

If you need any support or advice relating to this document, please email simone@shenward.com.

You can also connect with us in the following ways should you wish to find out more about how we can help individuals, and businesses just like yours.

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