

All change for VAT in the construction sector

The introduction of a VAT Domestic Reverse Charge (DRC) was planned for the implementation on 1 October 2019, however to give businesses in the construction sector more time to prepare, the implementation of this VAT change has been postponed until October 2020.

From October 2020 the rules surrounding the charging of VAT on goods and services will change and these changes will have a very significant impact on businesses operating within the construction sector.

The change relates to the introduction of a VAT Domestic Reverse Charge (DRC) and for construction businesses it will necessitate them changing the way they invoice and collect payments for their services or they risk significant potential VAT penalties.

What is a DRC?

At present when you provide your services to another business in a Construction Industry Scheme (CIS) environment if you are VAT registered you will normally add a VAT charge, typically at a rate of 20%, to the value of your invoice. Your customer will pay you for your services plus the VAT amount and in the fullness of time (up to 4 months later) you will pay the VAT collected to HMRC as part of your quarterly VAT return submission.

From October 2020, where your customer is another construction business, you will no longer add the 20% VAT element to your invoice and no longer collect the output VAT. Instead, you will need to modify your invoices to make it clear that the DRC applies and that the customer is required to account for the VAT.

The impact of these changes differs depending on whether you are subcontractor or contractor using subcontractors.

Subcontractors – impacts & recommended actions

The most significant impact of these new rules will be on your cashflow. Instead of collecting VAT and having the use of that money until you need to submit your next VAT return, you will no longer receive any VAT amounts from your customer and this could affect your cashflow.

In addition, you will need to ensure your book-keeping system is properly set up to produce invoices containing the correct information. You also must include a statement that makes it clear that the DRC applies, how much VAT is due and that the customer is required to account for the VAT.

Recommended actions for subcontractors:

- Assess what impact the new regulations will have on your cashflow.
- Assess whether the goods/services you are providing are covered by the new rules.
- For affected goods/services provided from October 2020 change your invoicing so that you no longer ask your customer to pay you VAT and you clearly state that it is their responsibility to account for the VAT on your supply to them.

Contractors – impacts & recommended actions

Firstly, care is needed not to inadvertently pay 'VAT' to subcontractors for CIS related goods and services received after October 2020 as you will be unable to reclaim this charge from HMRC. Your only recourse will be to go back to your sub-contractor and seek a refund of the overpaid amount. This provides you with a clear credit risk which needs to be managed.

Secondly, even if you do receive a correctly prepared invoice under the new rules your accounting processes are more complicated. Under the new rules you will only receive an invoice from your sub-contractor for the net amount. Therefore VAT will be accounted for by the creation of a payable amount due to HMRC and a cost to the P&L account or job costing record. However, you will need to remember that you have to make a second accounting entry to record equal and opposite input and output VAT. Any errors arising from these new processes could lead to a VAT return which is not correct which, in turn, could incur VAT penalties.

Recommended actions for contractors

- Ensure your sub-contractors are aware of these new regulations.
- From October 2020 reject any invoices from sub-contractors, whose services are affected by these new rules, unless they comply with the new regulations.
- Assess whether your accounting software can deal with the new regulations.
- Do not attempt to reclaim any inappropriately charged VAT from HMRC. This is a matter for you to resolve with your sub-contractor.

For further information and support with the introduction of the VAT Domestic Reverse Charge rules please speak to your usual Ensors contact or email our construction sector specialists barry.gostling@ensors.co.uk or robert.leggett@ensors.co.uk

Additional information can be found on the HMRC website:

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