

Guide to the Domestic Reverse Charge VAT for Construction

February 2021



Welcome to our Guide to the Domestic Reverse Charge VAT for Construction which comes into effect on 1 March 2021. For advice on how Xero can manage the Domestic Reverse Charge, please get in touch with Lee Sugden or Mark Tooby on **0161 761 5231**.

What is Domestic Reverse Charge VAT?

You may have heard that HMRC is introducing new VAT legislation for the construction industry - the Domestic Reverse Charge will come into effect in the UK on 1 March 2021. The measure was originally due to start in October 2019 but has been delayed twice due to Brexit and Coronavirus.

The Domestic Reverse Charge (DRC) is a new way of accounting for VAT and will apply to all VAT registered construction businesses in the UK. Put simply, the legislation moves the VAT liability from the supplier (subcontractor) of a service in the construction industry to the customer (contractor).

The new legislation is being introduced as an anti-fraud measure designed to counter sophisticated criminal attacks on the UK VAT system. It intends to cut down on "missing trader" fraud, where companies receive high net amounts of VAT from their customers but have no intention of paying the VAT to HMRC.

It's important to understand how this new legislation will affect your business processes, so we've put together this guide with the key information and our tips on getting prepared.

Exemptions

There are some exemptions to the DRC. The reverse charge does not apply to any of the following supplies:

- Supplies of VAT exempt building and construction services.
- Supplies that are not covered by the CIS, unless linked to such a supply.
- Supplies of staff or workers.

The reverse charge does not apply to taxable supplies made to the following customers:

- A non-VAT registered customer.
- 'End Users', ie a VAT registered customer who is not intending to make further ongoing supplies of construction.
- 'Intermediary suppliers' who are connected, eg a landlord and his tenant or two companies in the same group.
- Overseas customers. It only applies to UK companies providing building and construction services in the UK.

For further help or information, please contact **Lee Sugden or Mark Tooby on 0161 761 5231**.

How Will the Domestic Reverse Charge Affect Your Business?

How the DRC impacts your business depends on if you are acting as a subcontractor or a contractor.

If you are a VAT registered subcontractor (supplier) who provides building and construction services to a VAT registered contractor (customer) who is CIS registered, you no longer need to account for the VAT. Instead, your invoice should inform your customer that the VAT reverse charge is applied and they are responsible for the VAT using the reverse charge procedure.

If you are a VAT registered contractor (customer) you will instead account for both input and output tax on invoices you receive from your VAT registered subcontractors.

Here's a summary of the changes:

Current VAT accounting rules for construction firms (until March 2021)

A subcontractor (builder) supplies services and building materials to a contractor (construction firm). Under current rules, the seller must charge for VAT and declare the VAT to HMRC through their VAT return submission.

New VAT accounting rules for construction firms (after 1 March 2021)

A subcontractor (builder) supplies services to a contractor (construction firm). Under the new rules, the contractor must declare the VAT due on their VAT return and reclaim it subject to normal rules.



How to Prepare Your Business

The Domestic Reverse Charge (DRC) will be mandatory when it is introduced, so it's important if your business is affected that you are ready for the changes. Here's the top three areas to cover:

1. Ensure your software is up-to-date

If you use accounting software you'll need to check it will deal with the new VAT Domestic Reverse Charge. For example, if you are using desktop software, you will need to check with your supplier if a manual update is available.

If you use Xero, you're all set because the software has already been updated to help you comply with the DRC.

If you don't currently use software for your business then this is a great time to start. Using cloud accounting software like Xero makes life a whole lot simpler especially when dealing with CIS and VAT.

2. Consider your cash flow

Consider whether the change will impact your cash flow. If you are a subcontractor then it's likely your cash flow will be impacted as you will no longer be receiving the VAT payment from your customer.

If you are the contractor, you will likely have a short term cash flow benefit as you will no longer be paying the VAT amount to the subcontractor. However you must remember you will need to account for VAT as output tax (*box 1*) as well as input tax (*box 4*), along with the rest of your VAT accounting. **Contact Lee Sugden or Mark Tooby for help on 0161 761 5231.**

3. Communicate with your staff, contractors and/or customers

Make sure all of your staff who are responsible for VAT accounting are aware of the reverse charge and how it will work.

If you are a contractor, you should also be proactive in contacting your VAT registered subcontractors prior to 1 March 2021 to ensure they are aware of these changes and don't invoice you for VAT.

Likewise, if you are a subcontractor be sure to contact your contractor customers to make them aware you will be applying the DRC to invoices from 1 March 2021.

4. Get ready with Xero

Whether you are a subcontractor or contractor, Xero handles the DRC automatically, ensuring you have the right information shown on your CIS sales invoices. For CIS bills you receive, Xero will know you have to account for input and output VAT, and process appropriately - the hard work is done for you.

Xero includes:

- **Four new taxes to help you comply with the DRC:** 20% VAT on income, 5% on VAT income, 20% VAT expenses, 5% VAT on expenses.
- **Automatic DRC calculations** in your invoices, bills and credit notes.
- **Automatic DRC updates** on your Making Tax Digital return.

Using Xero as a subcontractor

If you are a subcontractor you need to ensure the DRC is reflected on your invoices. In Xero, you can use the 'Domestic Reverse Charge on Income' tax rates when raising invoices for construction services and related supplies. Xero will know that VAT should not be charged and will inform your customer that they are to account for VAT. If you are using Xero's CIS feature, it will also automatically calculate the CIS your supplier should withhold, so everything is done for you.

Using Xero as a contractor

If you are a contractor you need to ensure the DRC is reflected on the bills you receive from your subcontractors. In Xero, you can use the 'Domestic Reverse Charge on Expense' tax rates when posting bills for construction services and related supplies.

Xero will know that the reverse charge is to be applied and will automatically ensure the correct VAT is calculated. If you are using the CIS feature, Xero will also calculate the amount of CIS to withhold.

There's no need to worry when it comes to running your VAT return. Xero will do the work for you and ensure the boxes are updated with the correct values. It also gives you the option to drill down to details enabling you to check anything you need to.

5. Checklist

Your 'get ready' checklist

To be ready for the implementation date on 1 March, you need to make sure:

- ✓ You and your staff understand the new Domestic Reverse Charge for building and construction services rules, when it should be applied and when it shouldn't. HMRC has a wealth of resources on their website.
- ✓ Your accounting software has been updated to deal with the DRC (if you don't already use Xero).
- ✓ You consider the impact of any cash flow changes and speak to your accountant if needed.
- ✓ Your CIS customers and/or suppliers are informed that the DRC will apply to sales and/or purchases of building and construction services.

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