

Steps to get ahead of new VAT rules in construction



Overview

With the clock ticking until new VAT rules come into force, we have produced a helpful guide for those businesses which are affected.

The cashflow of 150,000 SME construction firms could soon be squeezed, when Government introduces a shake-up of VAT rules.

From October 1 2019, HMRC is introducing a new system, which means VAT cash will no longer flow between VAT-registered businesses in the construction supply chain.

Background to the VAT change

Construction firms have processed their own VAT for decades. Many SMEs use repayments from customers as a source of working capital before sending sums to HMRC.

Unfortunately, fraudsters took advantage of the system, claiming back millions of pounds-worth of VAT from customers before 'disappearing,' without re-paying the money to Government.

What is happening?

In a bid to tackle the crime, HMRC is introducing a new 'domestic reverse charge' for construction firms who provide specific services under the Construction Industry Scheme (CIS). It also applies to the provision of goods, where that forms part of a package of works covered by CIS.

Under the new arrangement, from October 1 2019, suppliers throughout the whole supply chain will need to issue domestic reverse charge notices to purchasers, highlighting which of their transactions would be subject to VAT.

Companies which serve end-users (clients) at the end of supply chains (this is likely to apply to main contractors) will effectively charge themselves VAT sums on behalf of suppliers, and recover the same VAT through their VAT returns, subject to normal rules. These companies will then charge VAT at the appropriate rate to the end-user (clients) in the normal way.

Who is affected?

The new VAT reverse charge only applies to:

- Sole traders, companies or partnerships operating in construction, which are VAT-registered in the UK, and which sell to other VAT-registered businesses.
- Sole traders or businesses which provide services specified under the Construction Industry Scheme (CIS).
- It will also apply to the supply of goods when provided under a 'package' of works which would be covered by CIS.
- Supplies which are subject to either the reduced (5%) or standard (20%) rates of VAT. Zero-rated services such as those in connection with the construction of new dwellings are unaffected.

What are the penalties?

Government has said it will operate a 'light touch' for six months after the introduction of the new rules. However, it is important construction companies get it right because incorrectly charged VAT is not recoverable. In a later stage, penalties may be issued on companies which accept incorrect VAT invoices.

What you need to do now – 6 steps to get ahead of new VAT rules in construction

1. Do your research

The changes only apply to specific construction services, or in certain scenarios, and only among VAT-registered businesses. Construction firms should visit the HMRC guidance page to check whether they are affected, how they are affected, and how they should process VAT.

2. Communicate

Buyers and suppliers are in this together. Talking openly about the changes will help everyone to get ahead. The earlier the supply chain can flag potential issues, the quicker issues can be solved.

It is the responsibility of the recipient of the services to inform suppliers whether it is the end user (client). This may be commercially sensitive but is essential for correct processing.

If domestic reverse charges are issued in error, HMRC will expect businesses at the end of supply chains to ask suppliers to provide a normal VAT invoice, with appropriately charged VAT.

3. Get your house in order

Before getting started with the new arrangements, it is vital that main contractors and suppliers check that their businesses are registered appropriately with the HMRC Construction Industry Scheme (CIS)

Buyers and suppliers operating within the construction sector should review their existing transactions with other VAT-registered companies and work out whether reverse charges apply to their sales, purchases or both.

Suppliers will need to establish which VAT-registered customers are end-users (clients) and which are other suppliers, in order to establish whether to issue reverse charge VAT invoices. HMRC recommend that suppliers obtain evidence of the customer's status in writing, particularly if the customer is the end-user.

When supplying services to other suppliers for onward sale, businesses should issue domestic reverse charge VAT invoices. The documents should include wording that the new reverse VAT rules apply on transactions.

When supplying services to an end-user/client (this often applies to main contractors), businesses should check that their suppliers have applied the correct VAT treatment on the services they have provided; whether the suppliers' services meet the criteria for the domestic reverse charge, or whether their suppliers should account for VAT in the traditional way. It is important to flag any rogue transactions because incorrectly charged VAT is not recoverable and firms will want to avoid potential penalties and disputes with HMRC.

You should submit a normal VAT invoice to end-users (clients) at the appropriate positive rate of 5% or 20% and process VAT payments on behalf of suppliers affected within your supply chain.

4. Cash is King – Prepare for a potential challenge

Subcontractors should consider the impact of a change to cash flow and put in place steps to protect themselves.

While changes to VAT are not expected to affect supplies by main contractors, it's worth larger firms being mindful of the impact on their suppliers.

Both main contractors and suppliers may well need to adapt their invoicing systems to accommodate the changes. Suppliers will need to send reverse charge VAT invoices, and main contractors will need systems to correctly account for, and report on, VAT sums.

5. Don't panic

HMRC has said that it may check for mistakes during the first six months after implementation.

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However, the agency will apply a 'light touch' on genuine mistakes, provided that companies are trying to comply with the new legislation and have acted in good faith. It will only consider penalties in the event firms are found to be deliberately taking advantage of the new rules.

In the meantime, HMRC recognises that this is a significant change and has issued lots of guidance for construction businesses.

Accountants and VAT specialists will also be able to help.

6. Keep good records

Construction buyers and suppliers must keep good accounting records to ensure compliance and be ready in the event of any investigation by HMRC. No one can deny that a new VAT regime will mean significant additional administration for construction businesses.

We all hope that eradicating fraud will help to stamp out unfair practices, level the playing field, and recognise the excellence of existing businesses within the construction industry.

The move has caused some concern among industry stakeholders including Constructionline, the National Federation of Builders, and specialist accountancy firm Rouse Partners, in terms of the potential impact on cash flow and increase in administration.

Chris Bates, chief financial officer at Constructionline, said: "While the construction industry fully supports any effort to tackle crime, we are hearing from the SME community that this could represent a big cashflow challenge.

"Many SMEs use VAT cash as something of a lifeline day-to-day, in an industry which is already managing significant challenges, including late payment issues, low margins, the rising cost of materials and the uncertainty of Brexit.

"For our buyer community, this will represent an increase in work, but it should not be excessive.

"Nevertheless, we are trying to help suppliers and buyers, by monitoring developments within HMRC, listening to feedback from customers and issuing relevant guidance whenever possible."

Nicola Gladwell, VAT consultant, Rouse Partners, added: "There is generally a low level of awareness about this change across the construction industry, and an even lower level of people who have taken active steps to prepare for compliance after 1 October.

"Construction businesses have had a lot on their minds in recent months. The VAT reverse charge may have been pushed aside but it is set to come to the fore, with thought and planning needed by all those working in the industry."

For Buyer and Supplier enquiries please contact Constructionline on
0333 300 2518