



VAT Practitioners' Group

Response to VAT: Reverse Charge for Construction Services

The VAT Practitioners' Group (VPG) is delighted to comment on the above consultation as follows:

1. Introduction

The VPG fully supports HMRC's endeavour to combat VAT fraud in the construction industry.

As experience in other EU Member States shows, a reverse charge mechanism in this market sector is an effective way of protecting the tax revenue - the financial basis for vital public services - and supports other, honest market participants.

It is however important that the new reverse charge will be easily applicable, will involve minimal administrative effort and that the surrounding regulations will be unambiguous in their interpretation. The VPG is concerned that the current proposal for a reverse charge for construction services does not fulfil these criteria, but adds further complexity.

As a large number of stakeholders are involved, any layer of VAT complexity will have a significant macroeconomic impact. The Government should show that it is serious about simplifying the VAT system, therefore ensuring the UK remains an attractive environment for enterprise.

2. Specific Comments

a) VAT Status of Recipient

The proposed reverse charge regulations force suppliers of construction services to determine the VAT status of their customers for themselves without knowing or being able to verify crucial facts.

In situations where the VAT status of the recipient of the construction services is unclear/ from the perspective of the subcontractor, "stand-offs" between contractual partners can take place, leaving the commercially weaker party to bear the VAT risk, disrupting business, creating mistrust or even destroying business relationships. The VAT risk can materialise itself many years later without a possibility to ask the customer for additional payment of the outstanding VAT and potentially resulting into serious financial consequences to the point of insolvency of the supplier. Even where contractual partners are willing to amicably resolve

the VAT situation by way of agreement, this will not secure both parties' tax positions because VAT law prevails.

Further, recipients of construction services might not know themselves whether they make "further supplies of specified services". There might be a severe time gap between incoming and outgoing construction services, the recipient's plans concerning the "use" of the construction services might not yet be determined, be aborted or might change, for example where construction services are then used privately. The current wording of the law also does not explain whether the term "further supplies" includes self-supplies. Where the recipient of a construction service is a member of a VAT group it is not clear whether the "use" of the construction services relates to the whole of the VAT group or to the specific VAT group member who ordered the construction services.

The above raises serious questions as to the conformity of the proposed reverse charge regulations with the Principle of Legal Certainty. Especially where a regulation entails serious financial consequences for a large number of businesses like the one discussed, it is important that those concerned know precisely the extent of the obligations which those rules impose on them (CJEU, *Isle of Wight Council and Others*, C-288/07, para 47).

Ireland has successfully operated a domestic reverse charge for construction services. This is linked to any contract that is subject to Relevant Contracts Tax ("RCT") and it is the responsibility of the main contractor to register the contract with the Irish Revenue. The contract is given a scheme number and each site within the scheme is identifiable. These details are passed to the sub-contractors who then register them with the Irish Revenue. Under this scheme, if RCT applies, so does the reverse charge and everyone in the chain is aware that the VAT liability is shifted to the main contractor.

Germany introduced a similar regulation to the proposed one for the UK for construction services in 2005 and it resulted in severe and prolonged problems, both for the industry and the tax authorities.

In order to avoid a similar situation and to allow legal certainty at least in a large part of the cases, the VPG proposes to add the following provision to the current wording of the "Specified Services and Expected Supplies" Order 2019: "A supplier can assume that his customer is making further supplies of specified services if HMRC confirms to the supplier for VAT purposes that the customer was a subcontractor under CIS at the time of supply of the specified services by the supplier." CIS has been operating for many years, and the industry is well accustomed to its registration and verification processes. They provide a simple and clear way to determine the tax status of subcontractors. A similar regulation was subsequently introduced in Germany.

For those companies not registered as subcontractors under CIS, the VPG proposes to

- introduce a process which allows those companies to apply to HMRC for confirmation that more than 10 % of their UK turnover relates to construction services and that they can therefore be deemed as "a person who uses those services for [...] further supplies of specified goods"; or
- in cases of doubt, allow parties to a contract of construction services to unanimously agree on the VAT liability of those services.

Further clarifications should be introduced in the text of the Order for VAT Groups and the allowable time lag between the purchase of the construction service and their use by the recipient for further construction services.

Given the severe issues resulting from the proposed article 8 lit a of the new Order, HMRC should also consider not introducing this provision at all. Article 395 (1) PVD, on which s 55V VATA 1994 and – indirectly – the proposed Order is based, does not set this requirement (cf. CJEU, *BLV Wohn- und Gewerbebau GmbH*, C-395/11, paras 36 et sqq).

Instead, the requirement in article 8(a) of the new Order will introduce a new level of complexity for a large number of taxpayers in direct contradiction to the Government's promise to simplify the tax system. Each construction service will have to be assessed from both, a CIS and VAT perspective. Smaller market participants who can only afford professional tax advice with great difficulty or not at all, will inevitably suffer. However, it is not evident why two sets of regulations are necessary to tackle the same problem, namely the loss of tax revenue through "missing traders" in the construction industry. It would be preferable to synchronise VAT and CIS regulations. VAT reverse charge could be applied to construction services whenever they would be subject to CIS.

b) Construction Services

According to Article 4 of the proposed Order, where services together with goods form part of a single supply of services the goods are subject to the new VAT reverse charge as well. However, if the services form part of a single supply of goods, the services must be singled out for reverse charge purposes, as Article 7 of the new Order commands. This is contradictory and stands in conflict to established VAT principles regarding single and multiple supplies. It also poses practical problems: For instance, where an industrial plant not located in a building is installed/assembled on site the supplier does not usually show the value of the work-related part. This can be due to various reasons, for example practical or because the supplier does not want to disclose his internal product calculation. In such cases the VPG proposes to either not apply the reverse charge to the entire mixed supply in accordance with established VAT principles or only apply it to those services which are separately identified (cf. similar regulation in para 21.1. VAT Notice 60 – Intrastat) in order to align the VAT reverse charge with CIS.

Under CIS small payments up to £1,000 of "deemed contractors" can be excluded from the application of the scheme. To minimise the administrative burden especially for smaller businesses this threshold should be replicated in the new VAT reverse charge regulations for construction services, at least for repairs and maintenance.

Further, the definition of construction services for the purposes of the domestic reverse charge is based on the CIS scheme, a system which has worked well in Ireland. However, in the UK, there is also a reverse charge for non-established persons supplying construction services to a UK established business (Section 8A (1) and (2), and Paragraph 1(2) (e), Schedule 4A, VAT Act 1994), which is different to the proposed domestic reverse charge definition. The definition of construction services under these provisions is restricted to:

"any works of construction, demolition, conversion, reconstruction, alteration, enlargement, repair or maintenance of a building or of a civil engineering work"

In addition, reverse charge also applies to:

"services such as are supplied by estate agents, auctioneers, architects, surveyors, engineers and others involved in matters relating to land"

(Paragraph 1(2) (f), Schedule 4A, VAT Act 1994)

The services of estate agents etc. are not covered by the proposed domestic reverse charge.

This means that taxpayers who use both, domestic and overseas contractors, will have to account for reverse charge by applying two different sets of definitions, which adds further complexity.

c) Tax Impact Note (“TIN”)

We note with interest that the introduction of the reverse charge will increase tax revenues. However, many sub-contractors in the sector will be receiving repayments as a result of purchasing materials supplied in the course of the construction services. This would increase the number of repayments lodged at HMRC. We would be interested to know whether this has been taken into account. The reverse charge would not prevent these claims from being made and taxpayers deregistering deliberately, opening up the possibility of repayment fraud within the chain.

Furthermore, the TIN also states that it estimates that between 100,000 and 150,000 taxpayers would be affected by the change. This is a large population that will require increased guidance from HMRC officers and the VPG is not convinced that HMRC currently has the resources to cope with potential enquiries from taxpayers. It also places an additional administrative burden on taxpayers in this sector, which is against the Government’s commitment to reduce the administrative burden on small businesses.



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National Technical Chair - On behalf of the VAT Practitioners' Group -

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