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VAT and the reverse charge on construction services

Why has it been introduced and how does it work in general?

From 1 March 2021, HM Revenue and Customs is introducing a reverse charge on certain construction services supplied in the UK. This means that, in parts of the construction services supply chain, VAT is not charged by the supplier but is accounted for by the recipient under the reverse charge mechanism.

A reverse charge is an anti-fraud measure and is designed to ensure that a supplier does not charge VAT and then not account for it to HMRC on its VAT returns. The introduction of the reverse charge in the construction industry is as a result of perceived widespread fraud in this sector.

It will only apply where construction services are “wholesaled” or onward supplied to another person in the chain. Therefore, final users will not need to operate the reverse charge. The reverse charge also only applies to services taxed at 5% or 20%. Therefore, most services in the course of construction of new houses and Relevant Residential Purpose (“RRP”) and Relevant Charitable Purpose (“RCP”) buildings will not be caught by the reverse charge.

What are “construction services”?

The definition of construction services for the purposes of the reverse charge is similar to that for the Construction Industry Scheme (“CIS”). Broadly, if you are supplying services that are caught by the CIS scheme, you will need to look at whether the reverse charge applies for VAT from 1 March 2021.

How does the reverse charge work? The reverse charge is a means of accounting for VAT by the recipient rather than the supplier. Instead of a supplier charging VAT on services and the recipient claiming that VAT as input tax, the recipient accounts for both output and input tax on its VAT return as follows:

Recipient calculates VAT at the appropriate rate (5% or 20%) on the value of the services from the supplier and includes this amount as output tax in Box 1 of the VAT return. The recipient then includes the VAT calculated in Box 4 of the return as if it was a purchase. The value of the services supplied is

included in Box 7 of the recipient’s VAT return.

For example:

A contracts with B to provide some bricklaying services for an office block valued at £1,000. Until 1 March 2021, B would charge:

£1,000 (value of services) plus VAT of £200 (at 20%) to A, making the invoice total £1,200 payable to B. B would include £200 in box 1 of its return as output tax and £1,000 in box 6 as its net sale.

A would claim the £200 VAT charged as input tax in Box 4 of its return and £1,000 in box 7 as a net purchase.

After 1 March 2021, B would only invoice £1,000 and would state that the reverse charge applies. A would only pay £1,000 to B.

A would then include the VAT element due (£200) in Box 1 of its return and would also claim that amount in Box 4. £1,000 would be included in Box 7.

Overall, the same amount of VAT is being accounted for, it is just the way that it is accounted for that is changing.

For more information on the implications for different business types, please see our additional briefing leaflets:-

- Developers and owners
- Main contractors & subcontractors
- Employment Bureaux and agencies

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