CHARTERGATES

SPECIALISTS IN TAX, VAT & EMPLOYMENT LAW

18.12.2020

Changes to the Domestic Reverse Charge for Building and Construction Services and further guidance

Previous newsletters in February and June 2019 and February 2020 have been following the changes in guidance for the Domestic Reverse Charge for Building and Construction Services ('DRC') legislation (Statutory Instrument 2019 No. 892). As you are aware, the legislation had a planned start date of 1st October 2019, but three weeks before that date HMRC issued a Brief delaying the start date by a year until 1st October 2020 on the basis that it appeared many businesses were not ready for the October 2019 start date (in part because communication about the new legislation had been inadequate). A further Brief was issued by HMRC on 5th June 2020 again delaying the start date of the legislation, this time to 1st March 2021 on the basis that the Covid-19 pandemic had put so much pressure on the business community that it made a start date of 1st October 2020 impractical.

Some aspects of the application of the DRC were unclear or difficult to work in practice and HMRC sought to address a couple of the most significant areas with a change to the legislation in June 2020 and the issue of a new VAT Reverse Charge Technical Guide in September 2020. This newsletter will discuss this change in legislation and how the new guidance has sought to clarify one of the areas that was causing confusion.

End users and Intermediary suppliers

The original version of the legislation excluded end users and intermediary suppliers (for definitions of these terms see section 2 of the statutory instrument) from the DRC. However, it was for the supplier to determine the status of his customer in this respect and even if his customer was co-operative in this it may have been unclear whether any of the exclusions applied and the parties could have been exposed to the risk of drawing the wrong conclusion. HMRC attempted to deal with this by stating in guidance that an end user had to tell their contractor that they had end user status, although there was no legal basis nor requirement for them to do so. This could have resulted in no VAT being accounted for at all with the contractor following HMRC's guidance, while the customer applied the legislation.

In June 2020, the requirement for the customer to notify a supplier of end user status was added to the Order in article 8(1A), thus aligning the legislation with the guidance issued by HMRC. This means that if a VAT and CIS-registered customer does not provide their supplier with notification of their end user status then the supplier of the construction services can use the DRC and charge no VAT and the customer will have to apply the reverse charge irrespective of their actual status. Contrary to the original intention, this means that customers can effectively 'opt-in' to the reverse charge by choosing not to notify suppliers of their end user status. While notification of end user status may have the advantage of maintaining the current position with its familiar accounting and payment of VAT to the supplier meaning no changes to the accounting systems, choosing not to notify seems to have greater advantages:

- ✓ it gives a cash flow advantage as the customer does not need to pay VAT to their supplier, but waits until the submission of the VAT return and payment of the liability to HMRC for the cash effect to crystallise

| T: 01908 533255 | F: 01908 410333
| www.chartergates.com | Company No. 8203425
| Chartergate Legal Services Ltd, 5-6 Rankin House, Murdoch Court
Roebuck Way, Knowlhill, Milton Keynes MK5 8GB

- ✓ the customer does not have to consider or make any checks to see whether they meet the conditions for end user status, and
- ✓ if status changes there is no need to worry about informing the supplier of that fact. (Article 8(1A) does not make any provision for withdrawing notification of end user status.)

Employment businesses and supplies by labour-only subcontractors

For VAT purposes a supply of labour-only operatives to a construction client could be either a supply of construction services or a supply of staff. The distinction is already important for determining the rate of VAT applicable to a supply (for example, a supply of construction services to a new build residential development would be at zero rate, whereas a supply of staff will always be standard rated) but will become more so when the DRC comes into operation because a supply of staff will not come under the DRC, irrespective of being a supply that comes under CIS and is between two VAT-registered businesses.

When the DRC legislation was drafted it was surprising to many that employment businesses and other labour supply scenarios were excluded from the rules. There ensued discussion between HMRC, businesses and consultants as to whether it was possible for there to be misunderstanding and confusing situations about the nature of a supply, with consequent lack of uniformity on the application of the DRC. In the VAT Reverse Charge Technical Guide HMRC have sought to give greater clarity of their intention, with sections 3 and 4 going into more detail on the difference between a supply of construction services and a supply of staff and endorsing that supplies by an employment business are not under the DRC, with section 3 stating:

> *"Employment businesses are treated differently for the purpose of the reverse charge. Supplies by employment businesses are not subject to the reverse charge, even if those supplies are within the scope of CIS.*
>
> *Employment businesses supplying construction workers are, for VAT purposes, treated as supplying staff rather than building and construction services.*
>
> *For VAT purposes, such activities of workers are supplies of staff by their employer and not supplies by the workers themselves. The supplier makes a supply of staff for VAT purposes if it provides another person with the use of an individual who is:*
>
> - ✓ *contractually employed or otherwise engaged by the employment business*
> - ✓ *a director of the employment business*
>
> *A similar situation arises with joint ventures, the construction firms that are parties to the joint venture provide workers on secondment to work on the joint venture project. Payments by the joint venture to each construction firm for their staff is not payment for construction services and therefore not subject to the reverse charge."*

Section 4 then gives bullet points to highlight the features that distinguish a supply of staff from a supply of construction services, attributing the former to being treated as a supply by an employment business and not under the DRC and the latter as a supply by a labour only subcontractor and being under the DRC.

As with all matters VAT related, HMRC will not only look at wording in contracts but will consider what is happening in practice if there is a question as to the nature of the supply. The pointers in section 4 as mentioned above will probably cover most scenarios, but do not preclude the possibility of a supply having

an equal number of matches from both lists, leaving the possibility of dispute between HMRC and the taxpayer concerning the nature of the supply and its consequent VAT treatment.

The risk to businesses of using the DRC (thus the supplier not charging VAT and the customer accounting for both the output tax and input tax recovery on a supply when they should have charged VAT) lies with the supplier. HMRC could assess the supplier for output tax not declared, along with charging interest and penalties. The supplier could, within the four-year time cap, charge that VAT on to his customer, and the customer could recover the input tax, but there is the possibility of the customer in the meantime having ceased trading or the customer delaying (or even refusing) the payment, which if significant could cause major cash flow issues.

Conversely, the risk to businesses of charging VAT when the supply should come under the DRC lies with the customer. HMRC could refuse input tax recovery to the customer on the basis that it is not genuine input tax as there should have been no VAT charged. Again, there are the possible commercial hazards of sorting that out between supplier and customer.

Are you prepared?

At the time of writing this newsletter the start date for the DRC coming into force is 1st March 2021, only just over ten weeks away. Whilst we cannot be sure that there will not be another delay due to Covid-19 (and perhaps a less than smooth change as the Brexit transition phase ends absorbing a lot of HMRC resource), with only a short time before implementation it would be advisable for clients to check that they are prepared for the DRC, particularly in the following areas:

- ✓ being sure whether your supplies to customers and from your suppliers are under the DRC
- ✓ having communication with suppliers and customers to confirm they agree with your understanding of the position
- ✓ reviewing any contracts that will straddle 1st March 2021
- ✓ considering whether to make agreements with customers to use the DRC across a whole contract and/or site where only some of the services supplied come under the DRC
- ✓ that the accounting software can cope with the invoicing and recording changes needed
- ✓ that cash flow effects have been considered
- ✓ the effect on payments on account has been considered
- ✓ whether it is appropriate to request monthly VAT return submissions
- ✓ that due diligence policies and procedures are adequate to mitigate risks for labour supplies not coming under the DRC

For further advice or information, including how Chartergates can assist your business in preparing for the DRC, or queries on VAT matters generally, please contact the Chartergates Team.