

CONSTRUCTION INDUSTRY SCHEME (CIS)

deans
your partner in business

Introduction

From 1 March 2021 an important change to VAT comes into effect when many contractors in the construction industry will stop paying VAT to their subcontractors. Instead, the contractor will pay the VAT directly to HM Revenue & Customs (HMRC) via the 'Domestic Reverse Charge' (DRC).

Why?

The DRC is aimed at combatting fraud in the construction sector labour supply chains. HMRC want to address the situation where unscrupulous sub-contractors lower down the supply chain charge VAT on the supply of services but do not then pay the VAT to HMRC.

Who will be affected?

The DRC will affect VAT standard (20%) and reduced rated (5%) supplies by sub-contractors if payments are reported through the Construction Industry Scheme (CIS). Whether the sub-contractor is a gross contractor, 20% contractor or 30% contractor is irrelevant - if they are subject to CIS reporting the DRC needs to be considered.

DOMESTIC
REVERSE CHARGES
FOR VAT



How will the DRC work?

If there is a CIS reportable transaction, DRC will apply to supplies between VAT registered sub-contractor and VAT registered contractor (subject to exceptions - see later).

Example

A VAT registered sub-contractor invoices a VAT registered main contractor £10,000 on 31 March 2021 for commercial construction work. The DRC applies as it is reportable under CIS:

The sub-contractor must raise an invoice for £10,000 with no VAT charged.

On the sub-contractor's VAT return they would make an entry of £10,000 in box 6.

On the main contractor's VAT return they would make the following entries:

Box 1 £2,000 (ie £10,000 x 20%)

Box 4 £2,000 (ie the other side of the reverse charge)

Box 7 £10,000

[The effect of this is to pass the responsibility for accounting for the VAT to the main contractor .](#)

What about materials?

Where CIS labour is invoiced together with materials the DRC will apply to the total invoice. This is a major difference to the operation of the CIS scheme.



Invoicing

A normal VAT invoice in line with the VAT Act should be generated by the sub-contractor. Additionally there must be a note on the invoice to make clear that the DRC applies and the customer is required to account for VAT. An example of a suggested narrative is:

Reverse charge - Customer to pay the VAT to HMRC - 20% (or £x,xxx)

This wording should appear by default if you are using accounting software - however see later.

End user exception

The DRC will not apply when providing building and construction services to an end user. End users are defined as consumers or final customers that essentially do not make onward supplies of construction services.

If an end user is registered for CIS as a contractor it is important that the sub-contractor gets confirmation in writing otherwise DRC will apply as the default position.

Accounting software

It is important that you ensure that your accounting software is fully up to date and can process the changes that DRC will make to VAT reporting. If you are in any doubt please contact your software supplier for confirmation.

Practical issues

For the sub-contractor

Inferior cashflow - some sub-contractors utilise the VAT collected on the supply as short-term working capital as they do not need to pay this over to HMRC until a month or so later. From 1 March 2021 this 'funding' will disappear and their business financing model may need to be revised.

Consider monthly VAT returns - it is likely that sub-contractors who only invoice under DRC will in the future be due regular repayments of VAT. As such they could elect to move to monthly VAT returns to obtain the repayment faster rather than waiting until a quarter end date.

For the contractor

Better cashflow - as the contractor will not have to pay over VAT to the sub-contractor

Risk - if the sub-contractor incorrectly charges VAT when DRC should have applied HMRC may disapply the input tax claim

Checking VAT and CIS status of customers

It would be prudent for sub-contractors to check the VAT and CIS status of new and existing customers. CIS status should be validated using HMRC's long established CIS online service.

For VAT HMRC have launched a new service to verify a customer's VAT number at:

www.gov.uk/check-uk-vat-number.



Preparing for DRC - checklist

- Understand which sales and/or purchases are with the DRC provisions
- Check that your accounting software is up to date and can process the DRC transactions together with the invoicing provisions for sub-contractors
- Ensure staff dealing with the accounting transactions are fully briefed to ensure correct entries are reflected on the VAT returns
- Ensure any impact the DRC has on cashflow are addressed in time
- If you have any questions about DRC or its effect please do not hesitate to contact us.

Useful links

HMRC

<https://www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services>

HMRC suppliers flowchart

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/878587/Annex_1_-_VAT_domestic_reverse_charge_for_building_and_construction_services.pdf

HMRC customers flowchart

<https://www.gov.uk/guidance/vat-reverse-charge-technical-guide#flowcharts>

Sage - <https://www.sage.com/en-gb/blog/vat-reverse-charge-construction/>

Sage webinar - <https://www.youtube.com/watch?v=yBIEou3meO4>

Gibson House | Hurricane Court | Hurricane Close | Stafford | ST16 1GZ

Tel: 01785 258311

www.deansaccountants.com