

VAT Reverse Charge

*Based on legislation on 2 February 2021
This may be deferred again*

You may have heard of VAT domestic reverse charge (DRC) for the construction industry, which is new legislation currently due to come into effect in the UK on **1 March 2021**, having previously been delayed from 2019 and then October 2020 by HMRC.

What is the VAT domestic reverse charge?

The VAT domestic reverse charge is a new way of accounting for VAT in the construction industry. It applies to VAT registered construction businesses and is an anti-fraud measure designed to counter sophisticated criminal attacks on the UK VAT system. It intends to cut down on “missing trader” fraud, where companies receive high net amounts of VAT from their customers but have no intention of paying the VAT to HMRC.

Exemptions

It *does not* apply for services supplied to **non-VAT registered individuals or businesses**, which means work done for homeowners/domestic users should be invoiced in the usual way.

It also does not apply to work done overseas. It **only** applies to **UK businesses** providing building and construction services in the UK.

What does it mean for you?

If your business is part of the Construction Industry Scheme then you will be affected by the legislation, so it is important you know how it will affect your business and processes as DRC will be a mandatory requirement from HMRC.

If you are a VAT registered subcontractor (supplier) who provides building and construction services to a VAT-registered contractor (customer) who is CIS-registered, then you no longer need to account for the VAT. Instead, your invoice should inform your customer that the VAT reverse charge is applied, and they are responsible for the VAT using the reverse charge procedure.

If you are a VAT-registered contractor (customer) you will instead account for both input and output tax on invoices you receive from your VAT-registered subcontractors. If your business is affected here is how you can prepare and apply the upcoming changes in Xero.

Ensure your software is up to date

If you use accounting software, you will need to check it will deal with the new VAT domestic reverse charge. For example, if you are using desktop software, you will need to check with your supplier if a manual update is available.

If you already use Xero, you are all set because Xero has already been updated to help you comply with DRC.

If you do not currently use software for your business, then this is a great time to start. Using cloud accounting software like Xero makes life a whole lot simpler especially when dealing with CIS and VAT.

Consider your cash flow

Consider whether the change will impact your cash flow. If you are a subcontractor then it is likely your cash flow will be impacted as you will **no longer** be receiving the VAT payment from your customer. If you are the contractor, you will likely have a short-term cash flow benefit as you will no longer be paying the VAT amount to the subcontractor, however you *must* remember you will need to account for VAT as output tax (box 1) as well as input tax (box 4), along with the rest of your VAT accounting.

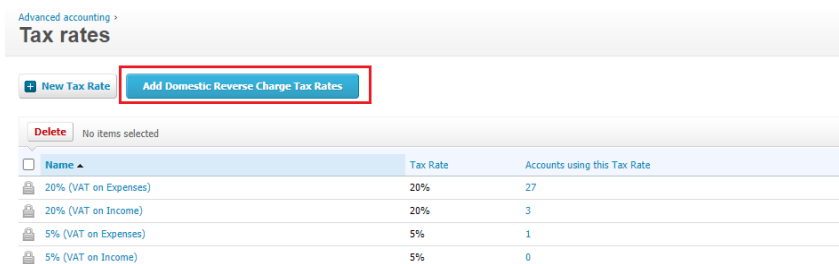
Communicate with your staff, contractors and/or customers

Make sure all your staff who are responsible for VAT accounting are aware of the reverse charge and how it will work. If you are a contractor you should also be proactive in contacting your VAT-registered subcontractors prior to the 1 March 2021 to ensure they are aware of these changes and do not invoice you for VAT. Likewise, if you are a subcontractor be sure to contact your contractor customers to make them aware you will be applying the domestic reverse charge to invoices from 1 March 2021.

How to activate the VAT domestic reverse charge in Xero

Whether you are a subcontractor or contractor, Xero calculates the domestic reverse charge automatically – so the hard work is done for you. 😊

To do this, we have added new VAT rates for domestic reverse charge in Xero. They need to be ‘switched’ on before they can be used. To do this simply select the ‘Add Domestic Reverse Charge Rates’ within the Tax Rates function in Advanced Accounting in Xero. This is shown below:



When you select the button, you will get the option of adding the following tax rates:



CBA Services Limited clients this has been already done for you

If you are a subcontractor, you need to use the **'Domestic Reverse Charge on Income'** tax rates when raising invoices for construction services and related supplies. Xero will know that VAT should not be charged and will inform your customer that they are to account for VAT. If you are using Xero's CIS feature it will also automatically calculate the CIS, your supplier should withhold. Here is an example invoice:

TAX INVOICE		Invoice Date		MP Plumbers and Electricians	
Wimpeys		30 Apr 2020		10 Willow Rise	
		Invoice Number		Little Billing	
		INV-0028		Northampton	
		VAT Number		Northamptonshire	
		544725044		NN3 9AR	
				UNITED KINGDOM	

Description	Quantity	Unit Price	VAT	Amount GBP
Working on housing	20.00	20.00	Domestic Reverse Charge @ 20% (VAT on Income)	400.00
Subtotal				400.00
TOTAL DOMESTIC REVERSE CHARGE @ 20% (VAT ON INCOME)				0.00
TOTAL GBP				400.00
Less CIS Deduction 20%				80.00
AMOUNT DUE GBP				320.00

Reverse charge applies to items marked with 'Domestic reverse charge'. Customers need to account for VAT on these items to HMRC, at the rate shown.

Due Date: 30 Apr 2020

If you are a contractor, you need to use the **'Domestic Reverse Charge on expense'** tax rates when entering bills for construction services and related supplies. Xero will know that reverse charge is to be applied and will automatically ensure the correct VAT boxes are updated on the VAT return. If you are using the CIS feature Xero will also calculate the amount of CIS to withhold. Here is an example:

From	Date	Due Date	Reference	Total
Eric Electric 58 Main Street Far Cotton Northampton NN1 5RL Edit address	12 Jan 2021	28 Feb 2021	Inv 0123	400.00

Item Code	Description	Quantity	Unit Price	Account	Tax Rate	Purchase Track...	Amount GBP
	Labour for wiring house in Welford	20.00	25.00	CIS Labour Expense	Domestic Reverse Charge @ 20% (VAT on Expenses)		500.00
Subtotal							500.00
Total Domestic Reverse Charge @ 20% (VAT on Expenses)							0.00
TOTAL							500.00
Less CIS Deduction 20%							100.00
AMOUNT DUE							400.00

Eric Electric has 24.00 in outstanding credit. [Credit this bill](#)

Other points to consider:

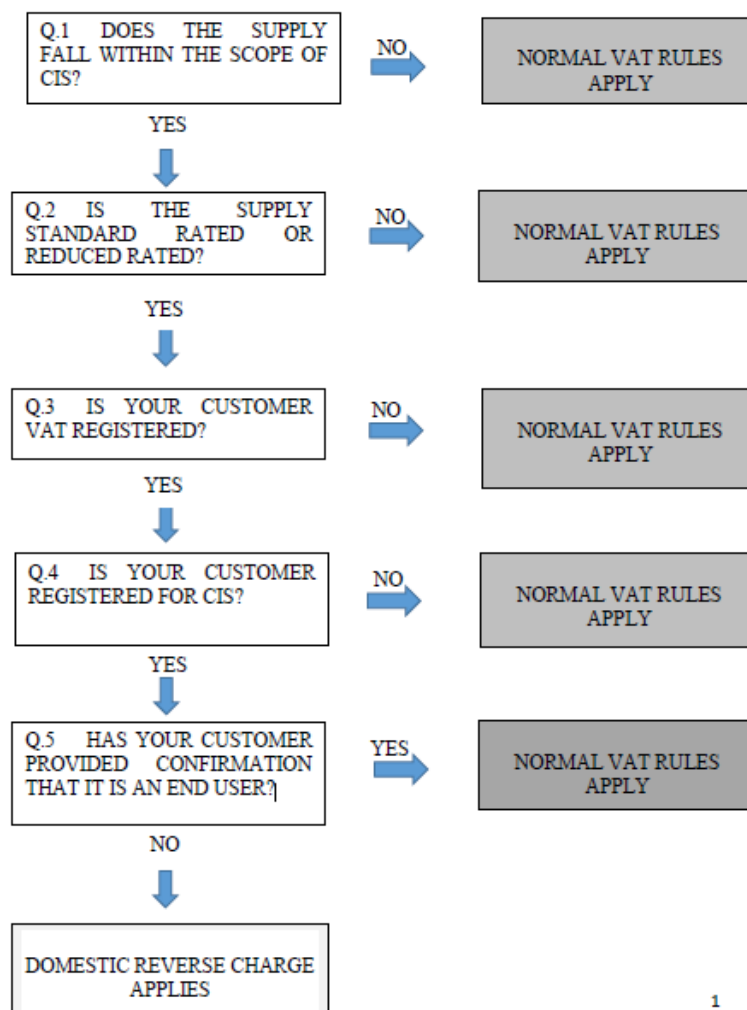
- The reverse charge may also mean your business will make net repayment claims to HMRC as you no longer receive VAT on your sales. If this is applicable, you may wish to move to monthly returns.
- Normally if any of the services in a supply are subject to the reverse charge ALL other services supplied will also be subject to it. However, if the reverse charge part of the supply is 5% or less of the value of the whole supply this can be disregarded (this is referred to as the "5% disregard") and normal VAT rules will apply if the customer makes an end user or intermediary supplier notification.

- If a customer enters into 2 separate contracts with the same supplier for works within the scope of CIS and the works are to be provided at the same time on the same site, the reverse charge will apply to both contracts (subject to the 5% disregard) as they comprise a single supply for VAT purposes
- If there is doubt whether a type of work falls within the definition of building and construction services, if the recipient is VAT registered and the payments are subject to CIS the reverse charge should apply.
- Transitional supplies arrangements for how to determine the VAT treatment for payments due on any supplies entered your accounting system is if the date entered is:
 - Before 1 March 2021 and the payment date will be on or before 31 May 2021, use the normal VAT rules
 - Before 1 March 2021 and the payment date will be on or after 1 June 2021 use the domestic reverse charge
 - On or after 1 March 2021 you must use the domestic reverse charge
- If you are on the cash accounting or flat rate scheme you will need to change scheme to the payments made or received scheme.

Flowchart for DRC for building and construction services

Use this flowchart to see how you would decide whether to apply normal VAT rules or apply the domestic reverse charge

Do not use it for services supplied by employment businesses



Example of a reverse charge invoice for one contract with different VAT rates

INVOICE				
To: Contractor (Customer) Customer's Address: Customer's VAT Registration No:		From: Sub-contractor (Supplier) Supplier's Address: Supplier's VAT Registration No:		
Invoice No: Invoice Date:				
Description	Net (£)	VAT Rate	VAT (£)	Gross (£)
Refurbishment of commercial premises	200,000	20%	Reverse charge applies	200,000
Conversion of office block to residential housing	150,000	5%	Reverse charge applies	150,000
Total	350,000			350,000
Customer to account to HMRC for the reverse charge output tax on the VAT exclusive price of items marked 'reverse charge' at the relevant VAT rate as shown above.				