

ACTIVE PRACTICE UPDATES

AUGUST 2019



McCleary & Company Ltd.
Chartered Accountants & Registered Auditors

CONSTRUCTION INDUSTRY SCHEME

And upcoming changes for reverse charge VAT.

Few sectors have such an impact in the UK as the construction industry. It not only provides the fabric of our nation – the places where we live and work – but also underpins our entire economy.

In 2017, construction contributed £113 billion to the UK economy, while construction output increased by 14% in 18 months to the end of September 2018.

Despite the looming prospect of leaving the EU without a deal on or before Halloween, demand for domestic construction projects remains high.

The Government aspires to build up to 300,000 new homes each year, and major infrastructure projects like the HS2 railway line, Crossrail in London, and Hinkley Point nuclear power station in Somerset continue to tick along.

The construction industry provides high-skilled jobs – many of which are also well paid – for more than 2.4 million people, according to the Office for National Statistics.

The scheme sets out rules for how payments to subcontractors for construction work must be handled by contractors in the industry, taking into account the subcontractor's tax status.

WHO DOES THE SCHEME AFFECT?

The scheme covers all construction work carried out in the UK, including tasks such as site preparation, alterations, dismantling, building, repairs, decorating and demolition.

It does not usually cover tradespeople who only do specific jobs, such as architects, surveyors, carpet fitters, manufacturers of construction materials, and those who deliver such materials.

However, an exception exists where a professional goes beyond their discipline to act as the developer or main contractor on top of providing their services.

While it does not apply to construction work taking place outside the UK, a business based outside the UK and carrying out construction work within it must register under the scheme.

The scheme covers all types of businesses within the construction industry, including companies, partnerships and sole traders. These businesses can be contractors, subcontractors or both.

The terms 'contractor' and 'subcontractor' have specific meanings under the construction industry scheme, which are much broader than is generally referred to within the industry.

CONTRACTORS AND SUBCONTRACTORS

A contractor is a business or other concern that pays subcontractors for construction work.

Private householders are not classified as contractors in the eyes of HMRC and therefore the scheme does not apply to them if they carry out work on their own home, such as having the kitchen extended.

A subcontractor is a business that carries out construction work for a contractor: for instance, electricians or plumbers who supply their services as part of a bigger construction project.

It is possible for a business to be treated as both a contractor and subcontractor, and different rules apply to both statuses.

These rules need to be followed very closely as getting this wrong could land you in trouble further down the line. Speak to us for further clarity.

HOW THE SCHEME WORKS

All contractors and subcontractors should register with HMRC for the construction industry scheme. Subcontractors will be subject to a higher-rate deduction if they have not registered.

Contractors deduct money from a subcontractor's payments and pass it to HMRC. These deductions count as advance payments towards income tax and national insurance, similar to PAYE.

A limited company will have deductions taken by the contractor from the income due to the company.

This deduction can then be offset against other company tax liabilities such as PAYE, VAT, corporation tax or can be refunded to the company after the end of the tax year.

Sole traders and partnerships will also have deductions made from the income they receive.

They are then required to report their gross income on their self-assessment tax returns, with contractor deductions also reported on the tax return and subsequently deducted from any income tax liability which is calculated as being due.

Contractors need to verify a subcontractor's status with HMRC before payment is made to establish whether they are registered and the correct amount of tax to withhold. Tax can be deducted at source at 0%, 20% or 30%.

Contractors must report all of the payments they have made under the scheme to the Revenue, or report they have made no payments in the tax month, by the 19th of each month.

Penalties apply if the monthly return deadline is missed.

DOMESTIC REVERSE CHARGE VAT FOR CONSTRUCTION SERVICES

HMRC's new domestic reverse charge for construction services comes into force on 1 October 2019.

From this point, a VAT-registered business that supplies certain construction services to another VAT-registered business for onward sale needs to issue a VAT invoice stating the service is subject to the domestic reverse charge.

However, the recipient must account for the VAT due on that supply through its VAT return, instead of paying the VAT amount to the supplier. The recipient may then recover the VAT as input tax, subject to the normal rules.

Unlike other types of reverse charge, the value of such reverse charge services will not count towards the VAT-registration threshold, which is good news for smaller businesses.

The new domestic reverse charge will apply to supplies of 'specified services'.

Among the specified services included are construction, alteration, repair, extension, painting and decorating, plus demolition, civil engineering and the installation of heating, lighting and air conditioning.

Some services will not fall within the scope of the domestic reverse charge.

Where there is a reverse charge element anywhere in a supply chain, however, then the whole supply may be subject to the domestic reverse charge.

PREPARATION

Construction businesses will need to ensure their accounting systems are capable of processing reverse charge supplies.

As the VAT amount must still be shown on invoices subject to the domestic reverse charge, there is a risk that suppliers will still account for the VAT to HMRC in error and likewise customers will still recover it from the Revenue.

Subcontractors that rely on VAT collected from their customers as working capital until they have to remit it to HMRC are likely to suffer from the loss of cashflow.

These businesses will need to consider if payment terms need to be revisited to avoid any problems in the supply chain this could cause.

Before these new rules take effect, construction businesses would be wise to:

- review supplies provided to, and received from, other VAT-registered contractors to establish where these will be subject to a reverse charge from October 2019
- obtain notification from customers, with details of their VAT-registration status, construction industry scheme status, and confirmation that they are the end-user
- consider any adaptations required to ensure accounting systems can deal with this change
- reflect on the negative effect on cashflow from October 2019, and ways to mitigate it.

Most accountants can help you navigate the complexities of the construction industry scheme and keep you compliant with the tax authority.

 **We can advise on the running of your business.**