



CIS VAT Domestic Reverse Charge (DRC) – At A Glance

- The CIS VAT DRC applies to business-to-business sales of construction work.
- The aim of the measure is to reduce VAT fraud in the construction sector.
- Where the DRC applies:
 - The customer accounts for the supplier's output VAT.
 - A reclaim can be made on the same return if the customer is entitled to recover the VAT.
 - The supplier does not charge or collect VAT on its sale.
- The CIS DRC only applies to UK business-to-UK business (B2B) supplies where the recipient of the supply intends to make an ongoing supply to another party of construction services.
- Commencement of the CIS DRC has been twice postponed due to the Coronavirus and Brexit. It is currently expected to commence on 1 March 2021.

The CIS DRC applies when all the following are met:

- There is a supply for VAT of construction services and materials.
- The supply is made at the standard or reduced rate of VAT.
- The supply is made between a UK VAT registered supplier and UK VAT registered customer.
- Both supplier and customer are registered for the CIS.
- The customer intends to make an ongoing supply of construction services to another party.
- The supplier and customer are not connected.
- The supplier is not an employment business.
- The customer is not an 'end-user'.

The CIS DRC does not apply to any of the following supplies:

- Supplies of VAT exempt building and construction services.
- Supplies that are not covered by the CIS, unless linked to such a supply.
- Supplies of staff or workers.
- Supplies of materials only.

The CIS DRC does not apply to taxable supplies made to the following customers:

- A non-VAT registered customer.
- A customer who is an 'end-user' i.e. a VAT registered customer who is not intending to make further on-going supplies of construction.
- A customer who is an 'intermediary supplier' and has informed the supplier of this status in writing.

CIS DRC requires a significant change of approach in many CIS businesses:

- Staff need to be trained to identify relevant CIS contracts and end-users.
- Accounting and bookkeeping systems require modification to cope with the new invoicing and reporting obligations.
- Use of the VAT Flat Rate Scheme and Cash Accounting may not be possible.
- Cashflow will be affected and those at the start of the supply chain may become VAT repayment claimants: they need to consider whether to file monthly returns.
- It may require a business who is the recipient of the supply to VAT register.

Example: how the CIS reverse charge works

John the Roofer (who is VAT registered) supplies the materials and roofs to a new office building for Contractor who (who is also VAT registered) and in turn supplies its construction services to Developer (also VAT registered). Developer finds and develops land and will, in this case, bring the build to completion and supply a finished commercial building to Enduser, its client.

- John the Roofer would, under the old VAT system, invoice Contractor £120,000, comprising of his £100,000 bill for materials, labour and works, plus £20,000 in VAT (at 20%).
- From 1 March 2021, under the new CIS reverse charge mechanism, he invoices £100,000. His invoice states that 'the CIS reverse charge applies' (see invoicing requirements in *Overview*) and that the applicable rate of VAT is 20%.
- Contractor pays John the net £100,000 fee. It then accounts for output and input VAT of £20,000 on the supply on its own VAT return.
- John does not account for output VAT in his accounting system as he has invoiced only his fee £100,000.
- As a consequence of the reverse charge procedure, John charges and receives £20,000 less than under the old system (where he would charge £100,000 + VAT) however he does not have to account to HMRC for any output tax on the transaction.
- When he is paid by Contractor, he includes the value of the sale in box 6 of his VAT Return. He does not add VAT to box 1 as he receives no output VAT.
- The change may well impact John's cashflow, as under the old rules, if Contractor was a prompt payer he could hope that he could use the £20,000 in VAT to purchase his materials. He could then purchase his materials and offset the input tax paid against his output liability.
- Contractor has a cashflow advantage, it does not have to pay John £20,000 and then at the end of its VAT quarter it cannot reclaim £20,000 as it is accounting for the reverse charge and the output VAT offsets the input VAT.
- As Contractor is supplying CIS services it must also consider the reverse charge. Will its client (Developer) be involved in the onward supply of CIS services? In this case, this may be difficult to determine as apparently Developer is selling a finished building to Enduser who is an investor and the reverse charge does not apply. It is Developer's responsibility to notify down the supply chain.

Information correct as at 6th February 2021