ZAZEN TAX

The VAT
Reverse Charge

For construction. What it is, when it applies, what it did to your cash, and what to do about that.

Eight chapters. The rule, and its consequences.

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Contents

Chapters one to four are the rule. Five to eight are what it did to the industry and what you can still do about it.

CHAPTER ONE What changed on 1 March 2021

The customer accounts for the VAT instead of you. That is the whole rule, and everything else is detail about when it applies.

Before that date a subcontractor invoiced with VAT on top, collected it, and paid it over on the next return. Afterwards, on most construction work between VAT-registered businesses within CIS, the subcontractor invoices the net amount and the customer declares the VAT.

It was introduced to stop missing trader fraud, where a supplier collected VAT and disappeared before paying it over. It worked, and it moved a large amount of working capital out of every subcontractor in the country on the same day.

CHAPTER TWO The six conditions

All six have to hold. Fail any one and you charge VAT in the normal way.

— The work is construction services within CIS
— You are registered for VAT
— The customer is registered for VAT
— The customer is registered for CIS
— The supply is standard or reduced rated, not zero rated
— The customer has not told you in writing that they are an end user or an intermediary supplier

The fifth is worth pausing on. New build residential work is zero rated, so it falls outside the charge entirely. A contract that begins as zero rated new build and moves into standard rated work moves into the charge with it.

Supplied on their own, architecture, surveying, consultancy, manufacturing components off site, installing seating, blinds, shutters or security systems, signwriting and artistic work are all outside the charge.

CHAPTER THREE The end user, and the notification

The condition that decides most real jobs, and the one you cannot answer yourself.

An end user is a business registered for both VAT and CIS that is not making an onward supply of the construction services it receives. The developer keeping the building, in other words, rather than the contractor passing the work along.

An intermediary supplier is a connected business that buys construction services and resupplies them without material change, connected either by having an interest in the same land or by being in the same corporate group.

> **IT HAS TO BE IN WRITING, AND IT IS THEIRS TO GIVE**
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> By post, by email, or written into the contract. Until it arrives the reverse charge applies and you must not charge VAT. The information sits with them and the risk of getting it wrong sits with you, which is why you ask at quoting stage rather than after they query the invoice.

Once given, it does not need repeating if the customer moves between end user and intermediary supplier status.

CHAPTER FOUR What goes on the invoice

Everything a VAT invoice normally carries, plus one line, minus the VAT on the total.

Wording HMRC accepts includes: VAT Act 1994 Section 55A applies. Or: Customer to pay the VAT to HMRC.

Show the VAT rate, or the VAT amount, that the customer has to account for, so they know what to declare. Do not add it to the total they pay you. That is the whole point.

On your VAT return

- The net value of the sale goes in box 6
- Nothing goes in box 1, because you charged no output tax
- Your input VAT is reclaimed exactly as before

CHAPTER FIVE What it did to your working capital

An amount you can calculate exactly, and which nobody budgeted for.

Before March 2021 you collected the VAT on every sale and held it until the return fell due. It was never your money. But while it sat in your account it did the same job as an overdraft, and it cost nothing.

The average balance you were holding is the VAT arising each month multiplied by half the return period plus the payment lag. On quarterly returns, with payment due a month and seven days after the quarter ends, that comes to about 2.7 months of VAT.

> **ON A £25,000 A MONTH SUBCONTRACTOR**
>
> £5,000 of VAT a month, held on average 2.7 months, is about £13,700 of working capital. It stopped arriving on 1 March 2021 and it did not come back. If you have not repriced since, your quotes are still assuming money that is no longer there.

CHAPTER SIX Monthly returns, and why most subcontractors want them

If your sales carry no VAT and your purchases do, every return is a repayment claim.

A subcontractor on the reverse charge charges no output tax and still pays VAT on materials, fuel, tools and plant hire. The arithmetic of that is a repayment position, quarter after quarter.

On quarterly returns you are lending that money to HMRC for an average of 2.7 months. On monthly returns it is nearer 1.7, and you get it back three times as often. On the same £25,000 a month business that is about £5,000 of cash released.

There is no downside beyond twelve returns a year instead of four, and if your bookkeeping is in order that is a smaller job than it sounds.

CHAPTER SEVEN The exceptions

Three worth knowing, one worth agreeing up front.

The 5 per cent disregard

If the reverse charge element is 5 per cent or less of the value of the whole supply, it can be ignored and normal VAT rules apply to all of it. Both sides have to agree that from the start of the contract, which means raising it before you sign rather than when the first invoice is queried.

Zero rated work

New build residential is zero rated and outside the charge. So is much conversion work at the reduced rate boundary, which is worth checking rather than assuming.

A notification arriving mid-contract

If the customer tells you they are an end user partway through, it applies from then. It does not rewrite invoices you already raised correctly under the charge.

CHAPTER EIGHT If you are the customer instead

The other side, which is usually cash neutral and occasionally is not.

- Account for the output tax in box 1, at the rate that would have applied
- Reclaim the same amount as input tax if you are entitled to
- Put the purchase value in box 7, not box 6

For most contractors that nets to nothing, which is why the charge moved cash out of subcontractors rather than out of the industry as a whole. If you cannot reclaim in full, because of partial exemption for instance, it is a real cost and worth modelling.

You also carry the obligation to tell your suppliers if you are an end user. Doing that promptly and in writing is a courtesy that costs nothing and saves your supply chain a great deal of unpicking.

Where to go next

The Reverse Charge Checker walks the six conditions and the disregard. The Cash Flow Calculator works out what the change cost you and what monthly returns would release.

Every calculator and workbook mentioned in this book is free on zazentax.com, with no email form. They use the same figures and the same rates as the chapters here.

Zazen Tax

Accountants for people who build things. If you would rather someone else did this, that is what we are for.

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