

## VAT reverse charge for construction services

15/06/2018

**Tax analysis: Etienne Wong, barrister at Old Square Tax Chambers, discusses the background to the draft legislation to introduce a VAT reverse charge for construction services, including how the charge would work, and its impact on businesses.**

### What is the background to the publication of this draft legislation?

The purpose of the proposed legislation set out in the draft Value Added Tax (Specified Services and Excepted Supplies) Order 2019 (2019 Order) is to combat supply chain fraud in the construction industry, particularly on large construction projects (such as private or public procurement civil engineering projects).

According to HMRC, organised criminal groups have been setting up businesses that collect VAT from customers that they then fail to pay to HMRC. The loss of—not just VAT, but also income tax and National Insurance contributions—revenue from this type of fraud in the construction industry is estimated by HMRC to be in the tens of millions.

The proposed legislation applies to the construction industry, which is the same technique that HMRC has used effectively to combat similar types of fraud in the telecommunications and energy sectors.

### How would the proposed reverse charge work?

Ordinarily, where a person who is (or who is required to be) registered for VAT—ie a ‘taxable person’—makes a supply (whether of goods or services) to another person, and VAT is chargeable on that supply at a positive rate, the taxable person making the supply is the person required to account for, and pay, the VAT to HMRC. [Section 55A\(6\)](#) of the Value Added Tax Act 1994 ([VATA 1994](#)) provides for an exception to this general rule, using the ‘reverse charge’ mechanism.

Where [VATA 1994, s 55A\(6\)](#) applies, it is the person receiving the supply who is required to account for, and pay, the VAT to HMRC.

[VATA 1994, s 55A\(6\)](#) applies where:

- the recipient is also a taxable person
- the recipient is receiving the supply in connection with the conduct of a business by him
- the goods or services in question are specified as items to which [VATA 1994, s 55A](#) applies in secondary legislation
- the supply is not an ‘excepted supply’

The 2019 Order specifies ‘construction services’ as services to which [VATA 1994, s 55A](#) will apply.

‘Construction services’ are defined for these purposes, using as its base the definition of ‘construction operations’ (in [section 74](#) of the Finance Act 2004) for the purposes of the construction industry scheme.

### What exceptions are provided in the draft legislation, and what is the rationale for these?

The 2019 Order also sets out ‘excepted supplies’—ie supplies of ‘construction services’ that will not fall within the reverse charge provided for under [VATA 1994, s 55A](#).

Excepted supplies of construction services are supplies made to persons who do not then use them to make further supplies of construction services—ie supplies made to final consumers of the construction services (such as a retail business that buys and consumes construction services but is not itself a construction business).

The reason why final consumers have been exempted from applying the reverse charge is because HMRC has not found fraud at the final consumer stage.

Also excepted are supplies made to a person who is 'connected' (within the meaning of the 2019 Order) with the final consumer, who then uses the supplies to make a further supply of construction services to the final consumer, and supplies made to landlords who then on-supply to tenants who are final consumers (and vice versa).

### **The tax information and impact note describes the impact on business as significant. Which businesses would be most affected, and why?**

All construction businesses will be affected. This is a real issue, if only because the construction industry is significantly larger than the telecommunications and energy sectors—HMRC's own estimate is that there are approximately 250,000 VAT-registered construction businesses. The impact will be felt all the more because the vast majority of these businesses are small or micro-sized and the concern is that they may not have sufficient experience with the reverse charge mechanism to administer it properly.

### **From the government's perspective, do you think the change is likely to have its desired effect?**

HMRC is clearly hoping to achieve the same success it has had with the telecommunications and energy sectors. The real challenge is whether HMRC could effectively prevent fraudsters from simply moving on to, and continuing their modus operandi in, another industry or sector.

### **When would the new reverse charge come into effect?**

HMRC is consulting on the draft 2019 Order. The final version of the proposed legislation is expected in October 2018. If implemented, the new provisions will come into effect on 1 October 2019.

HMRC believes this would give the industry sufficient time to prepare for the change, but businesses may disagree.

*Interviewed by Susan Ghaiwal.*

*The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor.*