CIS Domestic Reverse Charge

Theory, preparation and Implementation in Sage 50cloud Accounts and Sage Business Cloud Accounting

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Agenda

Part 1 – Theory and preparation steps

- Introduction
- Domestic Reverse Charge legislation overview
- Missing trader fraud
- Solving the 'missing trader fraud problem’
- How to prepare for Domestic Reverse Charge
- Other considerations

Part 2 – Implementing the Domestic Reverse Charge changes

- Incoming supplier invoices where Domestic Reverse Charge applies
- Issuing customer invoices where Domestic Reverse Charge applies
- Effect on VAT returns
- Frequently asked questions
- Further support and help

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Theory

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Domestic Reverse Charge

Background

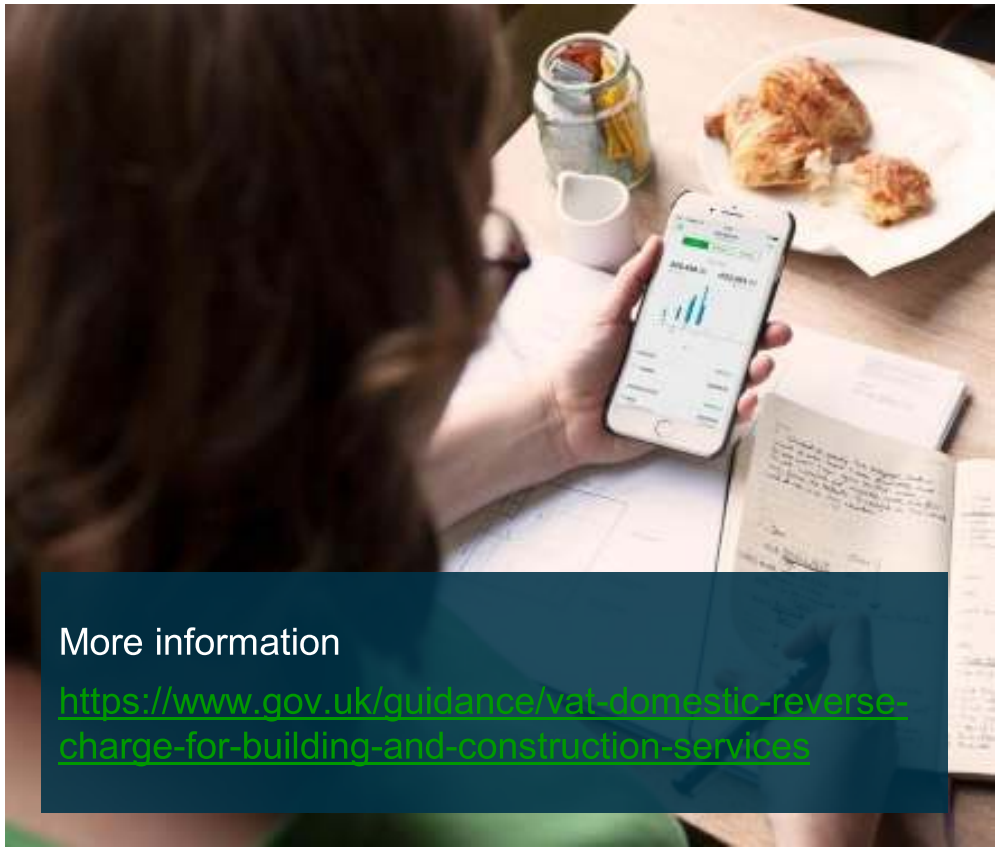
Originally planned for October 2019, but has moved twice

- Now postponed again to March 2021 due to the Covid-19 Pandemic

This new legislation will apply to most businesses involved in the supply of building and construction services

Domestic Reverse Charge applies to both standard and reduced rate services:

- For business's registered for VAT in the UK who buy or sell services that are reported under CIS



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Domestic Reverse Charge

HMRC policy objective

- Changes the way in which VAT is processed in the construction industry
- Has no impact on the CIS process which covers tax and NI. The reverse charge covers VAT.
- Anti fraud measure to prevent missing trader fraud
- There will be penalties for non-compliance
- Estimated to impact 150,000 businesses in the construction and building sector

Liability transfer

- The legislation removes the liability to collect and pay from each subcontractor in the supply chain
- The final contractor in the supply chain pays the VAT to HMRC

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Missing trader fraud

What is missing trader fraud?

Missing trader fraud was projected to cost the exchequer **£90m in 2019/20**, and **£140m in 2020/21**

- A subcontractor invoices the main contractor
- Adds 20% VAT
- Main contractor pays invoice due including VAT to subcontractor
- Main contractor reclaims the VAT from HMRC
- Subcontractor **declares the VAT, paying it back to the HMRC**

- A subcontractor invoices the main contractor
- Adds 20% VAT
- Main contractor pays invoice due including VAT to subcontractor
- Main contractor reclaims the VAT from HMRC
- Subcontractor **disappears without filing their tax returns and without paying the VAT to HMRC**, effectively stealing this money

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Normal VAT

POVEY & SONS

BUILDING SERVICES

INVOICE

Description	Net	VAT
Labour	£500	£100
Materials	£500	£100
Total	**£1000**	**£200**

Subcontractor	Main Contractor	HMRC

1 Charges £1200

Subcontractor bills the main contractor gross £1200

Pays £1200 2

The main contractor makes payment to the subcontractor

3 Recovers £200

Main contractor recovers the VAT as purchase tax

-£200

HMRC repay the VAT to the main contractor

4 Pays £200

Subcontractor must pay the VAT due as sales tax

+£200

HMRC receive the VAT from the subcontractor

Banks £1000 5

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Normal VAT

POVEY & SONS

BUILDING SERVICES

INVOICE

Description	Net	VAT
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Total	**£1000**	**£200**

Subcontractor	Main Contractor	HMRC

1 Charges £1200

Subcontractor bills the main contractor gross £1200

Pays £1200 2

The main contractor makes payment to the subcontractor

3 Recovers £200

Main contractor recovers the VAT as purchase tax

-£200

HMRC repay the VAT to the main contractor

4 Pays £200 **Missing Trader Fraud** **+£200**

Banks £1200 5

HMRC are now down by £200

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The solution

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How does the HMRC intend to combat missing trader fraud?

HMRC are introducing **Domestic Reverse Charge**

In summary, the legislation is concerned with moving the VAT liability from the supplier of a service (the subcontractor) to the customer (the contractor)

This reverse charge will apply right through the supply chain up until the point where the customer is no longer a business or is an end-user

The DRC will apply to any “construction services” covered by the CIS, and any goods supplied in conjunction with them. Therefore invoices that are a mix of CIS and non-CIS will also apply under Domestic Reverse Charge.

‘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 the ‘5% disregard’) and normal VAT rules will apply if the customer makes an end user or intermediary supplier notification’.

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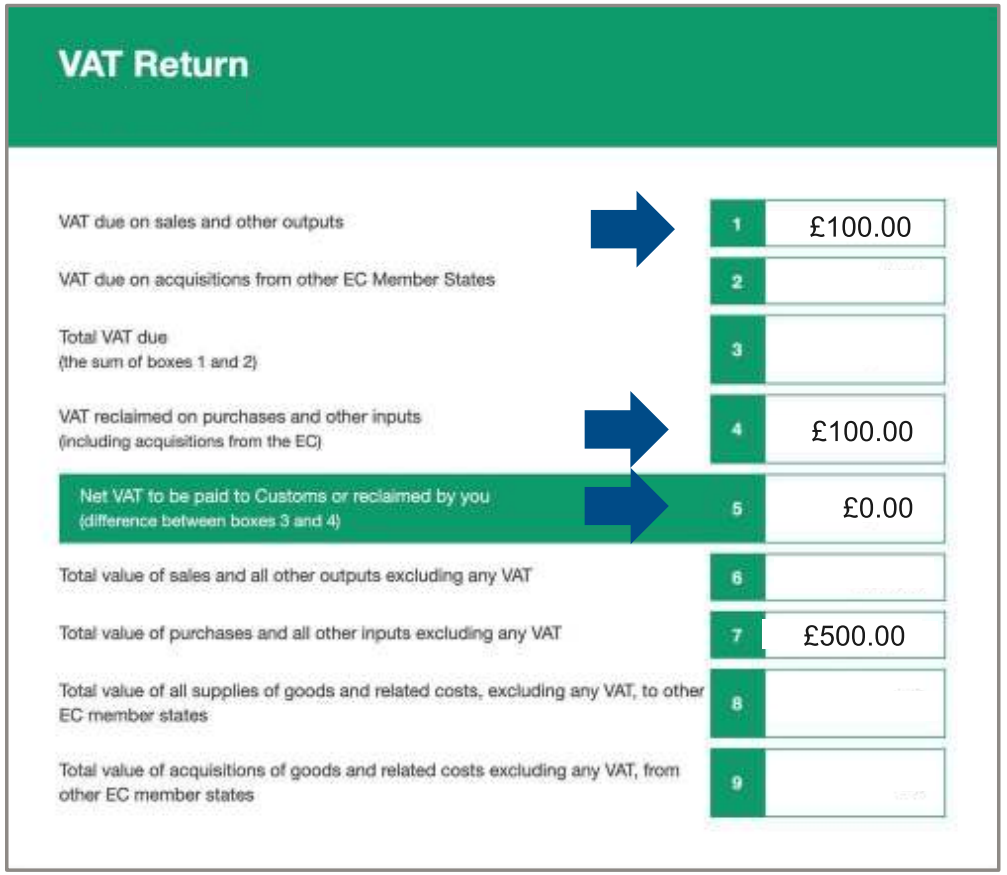
Notional VAT

Reverse charge will apply notional VAT on the VAT return

Notional VAT affects both sales and purchases therefore no Overall VAT is due

Notional VAT allows HMRC to analyse the amount of VAT had normal VAT rules applied

Our products will introduce features to account for this notional VAT automatically



VAT Return

VAT due on sales and other outputs	1	£100.00
VAT due on acquisitions from other EC Member States	2	
Total VAT due (the sum of boxes 1 and 2)	3	
VAT reclaimed on purchases and other inputs (including acquisitions from the EC)	4	£100.00
Net VAT to be paid to Customs or reclaimed by you (difference between boxes 3 and 4)	5	£0.00
Total value of sales and all other outputs excluding any VAT	6	
Total value of purchases and all other inputs excluding any VAT	7	£500.00
Total value of all supplies of goods and related costs, excluding any VAT, to other EC member states	8	
Total value of acquisitions of goods and related costs excluding any VAT, from other EC member states	9	

Example of VAT Return of a main contractor

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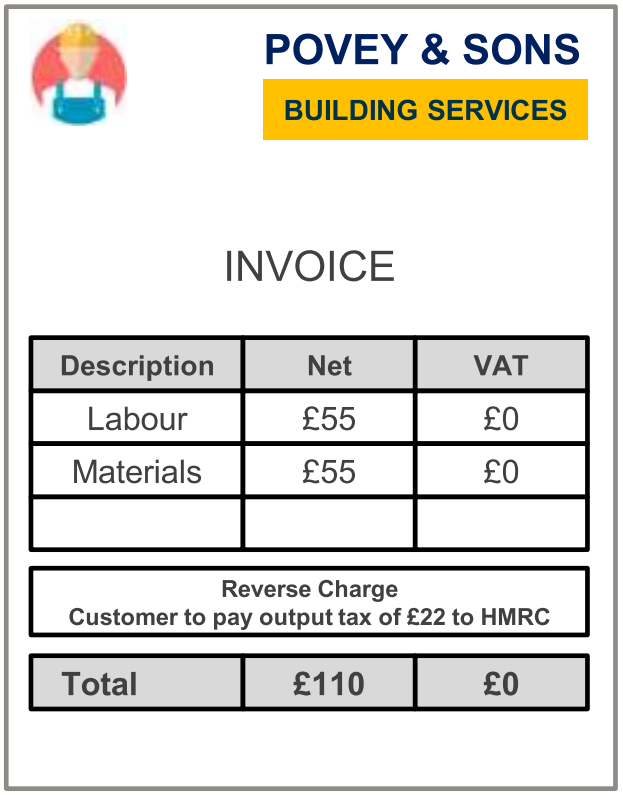
Domestic Reverse Charge requirements?

- Purchase invoices and purchase credits using reverse charge will populate box 7 with the net amount, and boxes 1 and 4 with the notional VAT amount
- For sales invoices and sales credits, using reverse charge will impact box 6 with the net amount only
- It is important to remember that the invoice must clearly state the transaction is subject to reverse charge
- HMRC have provided examples of the wording which meets legal requirements on the link below



POVEY & SONS

BUILDING SERVICES

INVOICE

Description	Net	VAT
Labour	£55	£0
Materials	£55	£0

Reverse Charge
Customer to pay output tax of £22 to HMRC

Total	**£110**	**£0**

https://www.gov.uk/guidance/vat-reverse-charge-technical-guide#invoices

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Domestic Reverse Charge

End-users

The reverse charge does not apply to supplies to end-users where the end-user tells their supplier or building contractor in writing that they're an end-user.

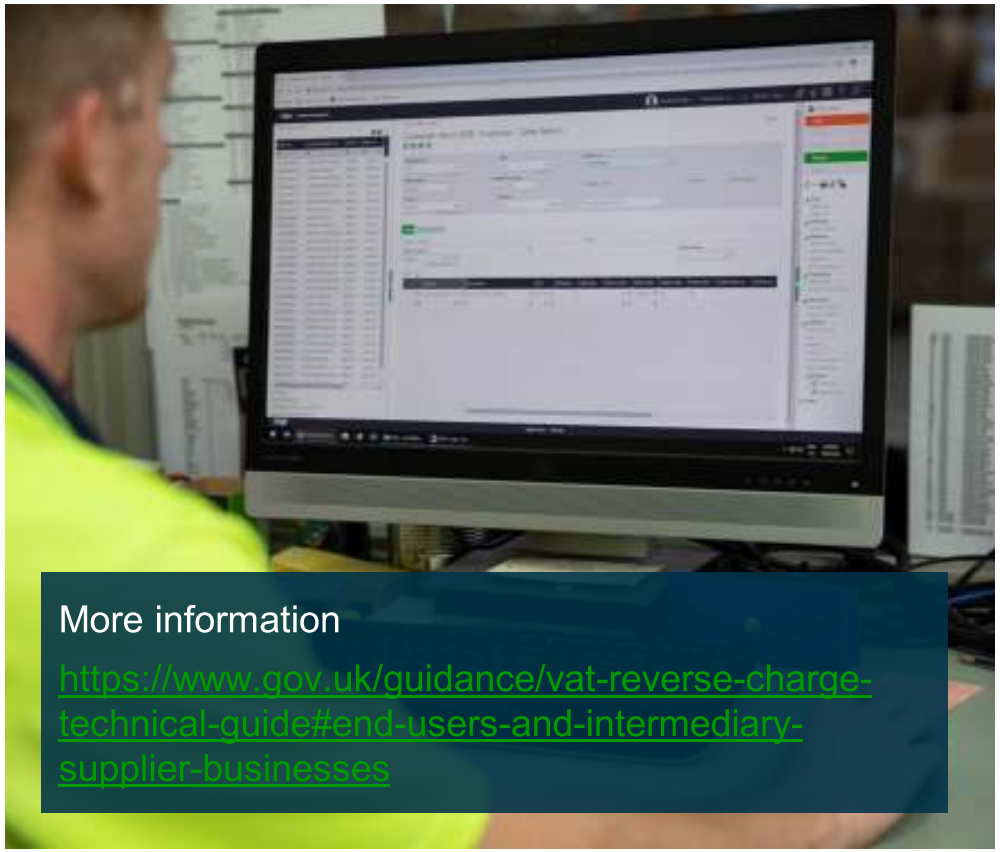
Intermediary

If intermediary suppliers buy construction services and re-supply them to a connected or linked end-user, without making material alterations to the supplies, they're all treated as if they're end-users and the reverse charge does not apply

Written notification

Written notification of end-user or intermediary status must be made:

- In writing
- Via Email
- In a contract



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How to apply the Domestic Reverse Charge

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Things to consider

Domestic Reverse Charge does not apply to every single transaction.

The supply chain needs to be considered.

- Is the service being supplied subject to CIS?
- Is the Supply subject to standard or reduced rate VAT?
- For suppliers, is the supplier VAT Registered?
- Are your customers end-users or provided onward supply of services?
- What is the Tax point of the transaction?
- Only the end customer pays the VAT

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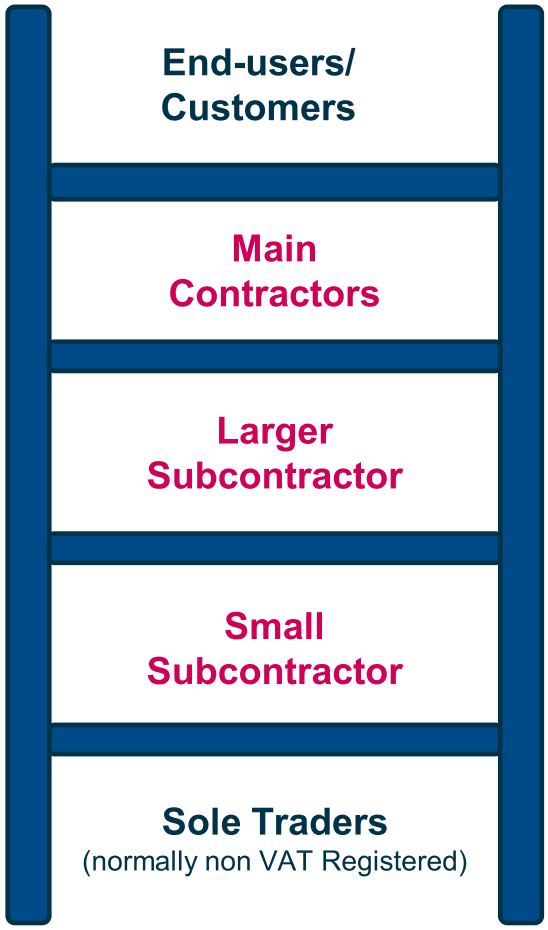
What you should know by now



It is important for you to assess where you sit in the supply chain as it may have different implications on how you process the new DRC

It may be that in different contracts you are in different positions of the supply chain, so it is key to understand each of the different levels

You will need to consider who your suppliers are:

- Are they VAT Registered?
- Is the service they are supplying subject to DRC?

You will also need to consider who your customers are. Are they end-users, or do they have an onward supply of services?

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Steps for the small subcontractor

The old process

The small subcontractor charges 20% VAT on invoices issued to the larger subcontractor and should pay the VAT charged to HMRC.

Charges on Sales invoice	£110 + £22 VAT
Pays HMRC	£22

The new process

The small subcontractor will no longer charge for the VAT on their invoices to the larger subcontractor. They will however indicate Domestic Reverse Charge to demonstrate the amount of VAT that would have been paid under normal circumstances.

Charges on Sales invoice	£110 + Reverse Charge VAT(£22)
Pays HMRC	£0 VAT

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Steps for the larger subcontractor

The old process

The large subcontractors use small subcontractors but are also subcontracted themselves.

Charges on Sales invoice	£120 + £24 VAT
Recovers from Purchase invoice	£22 VAT
Pays HMRC	£2

The new process

The new process means they will record this notional reverse charge based on the purchase invoice their subcontractor issued them.

Charges on Sales invoice	£120 + reverse charge VAT (£24)
Declares DRC on Purchase invoice (box 1)	£22 reverse charge VAT
Declares DRC on Purchase invoice (box 4)	£22 VAT Purchase Tax
Pays HMRC	£0 VAT

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Steps for the main subcontractor

At the final step of the supply chain a contractor will need to invoice an end-user

The old process

The main contractor is still not the end of the chain as they use subcontractors but are invoicing the end customer.

Charges on Sales invoice	£130 + £26 VAT
Recovers from Purchase invoice	£24 VAT
Pays HMRC	£2

Under the old process, they would recover the £24 charged by their subcontractor and pay VAT on invoices they send to their main contractor, the net effect being a payment of £2 to HMRC.

The new process

The new process means they will record this notional reverse charge based on the VAT reverse charge value their subcontractor issued them.

Charges on Sales invoice	£130 + £26 VAT
Declares DRC on Purchase invoice (box 1)	£24 reverse charge VAT
Declares DRC on Purchase invoice (box 4)	£24 VAT Purchase Tax
Pays HMRC	£26

However when they issue an invoice to their customer they now process this as normal indicating the VAT due and pay this to HMRC.

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Reverse charge – Impact on the supply chain

		VAT Currently		Reverse Charge VAT – 1st March 2021
Customer	Pays	£130 + £26 VAT	Pays	£130 + £26 VAT
Main Contractor	Charges	£130 + £26 VAT	Charges	£130 + £26 VAT
	Recovers	£24 VAT	Recovers	£24 VAT Purchase Tax
	Pays HMRC	£2	Accounts for	£24 Reverse Charge VAT
			Pays HMRC	£26
Large Subcontractor	Charges	£120 + £24 VAT	Charges	£120 + Reverse Charge VAT
	Recovers	£22 VAT	Recovers	£22 VAT Purchase Tax
	Pays HMRC	£2	Accounts for	£22 Reverse Charge VAT
			Pays HMRC	£0 VAT
Small Subcontractor	Charges	£110 + £22 VAT	Charges	£110 + Reverse Charge VAT
	Recovers	£0 VAT	Pays HMRC	£0 VAT
	Pays HMRC	£22		
Self Employed Worker (Non-VAT Registered)	Charges	£100 + £0 VAT	Charges	£100 + £0 VAT
	Pays HMRC	£0 VAT	Pays HMRC	£0 VAT

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Other considerations

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Cashflow

The old process

The small subcontractor charges 20% VAT on invoices issued to the larger subcontractor and should pay the VAT charged to HMRC.

Charges on Sales invoice	£110 + £22 VAT
Pays HMRC	£22

The new process

The small subcontractor will no longer charge for the VAT on their invoices to the larger subcontractor. They will however indicate Domestic Reverse Charge to demonstrate the amount of VAT that would have been paid under normal circumstances.

Charges on Sales invoice	£110 + Reverse Charge VAT(£22)
Pays HMRC	£0 VAT

- There could be potential cashflow issues for small businesses who use the VAT collected from customers as temporary working capital before paying it to HMRC.
- These businesses will need to consider how they can work without this VAT.

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Repayment traders

- In some circumstances, some business may find themselves becoming what is termed a repayment trader.
- This is where due to them no longer collecting and paying VAT on their sales to HMRC they are due a net reclaim rather than a net payment on their VAT returns.
- These businesses can request to move on to monthly VAT returns if they wish to speed up the repayments to them. This will need to be requested through HMRC.

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Preparation

Businesses should:

- ☑ Review supplies made to and received from other VAT Registered contractors to establish if these are subject to reverse charge
- ☑ Understand your customers and suppliers
  - Do your customers have an onward supply or are they the final link in the chain?
  - Are your suppliers aware of the changes do they know to apply DRC to your invoices if they are VAT Registered?
- ☑ Consider the changes to your accounting system to deal with this change
- ☑ Consider changes to wording on invoices where DRC applies
- ☑ Consider the Cash flow impact to your business

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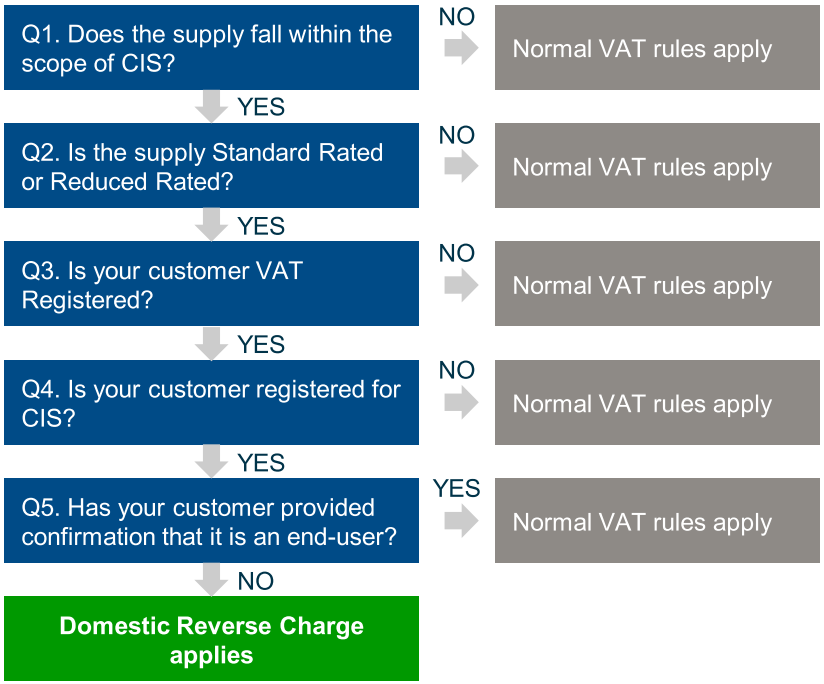
HMRC flowchart

VAT: Domestic Reverse Charge for building and construction services

Annex 1

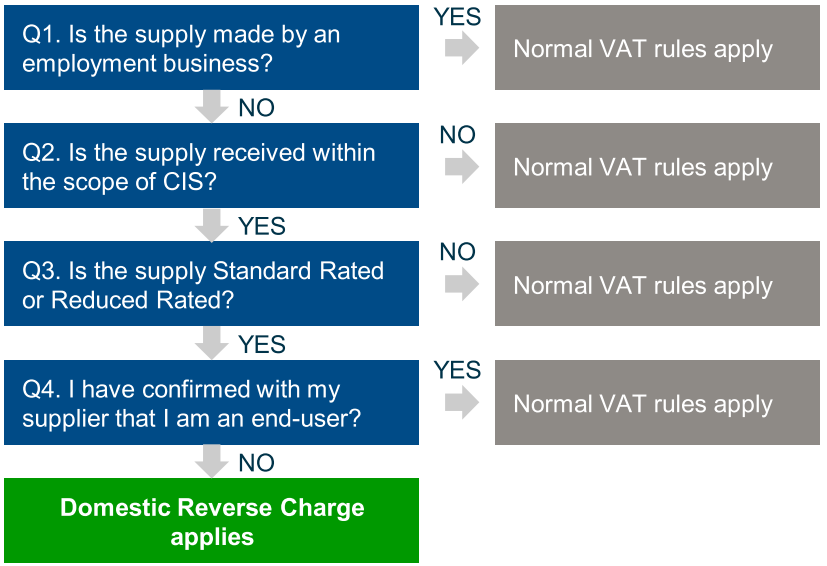
Use this flowchart to see how you would decide whether to apply normal VAT rules or apply the Domestic Reverse Charge.

Do not use it for services supplied by employment businesses.



Annex 2

This flowchart is to help businesses receiving building and construction services check whether normal VAT rules or Domestic Reverse Charge.



https://www.gov.uk/guidance/vat-reverse-charge-technical-guide

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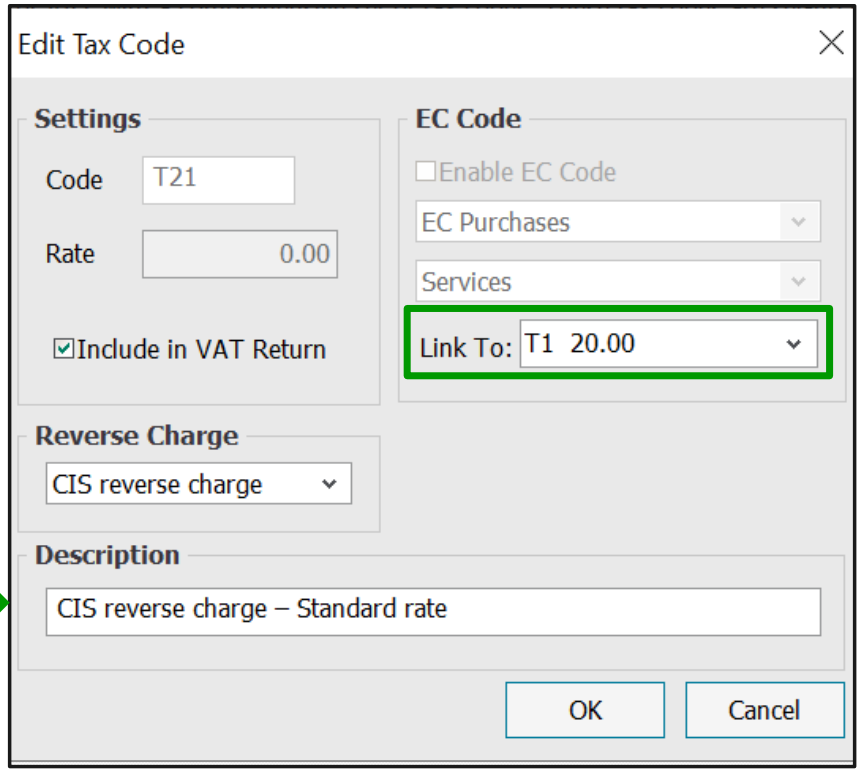
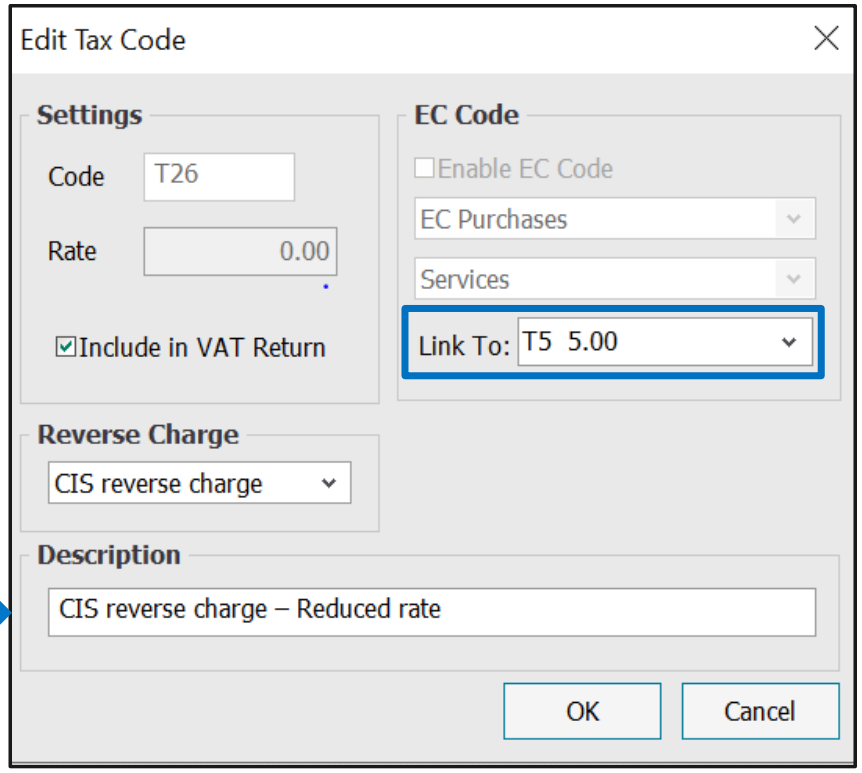
Solution 2 x new tax codes

sage

T21



T26



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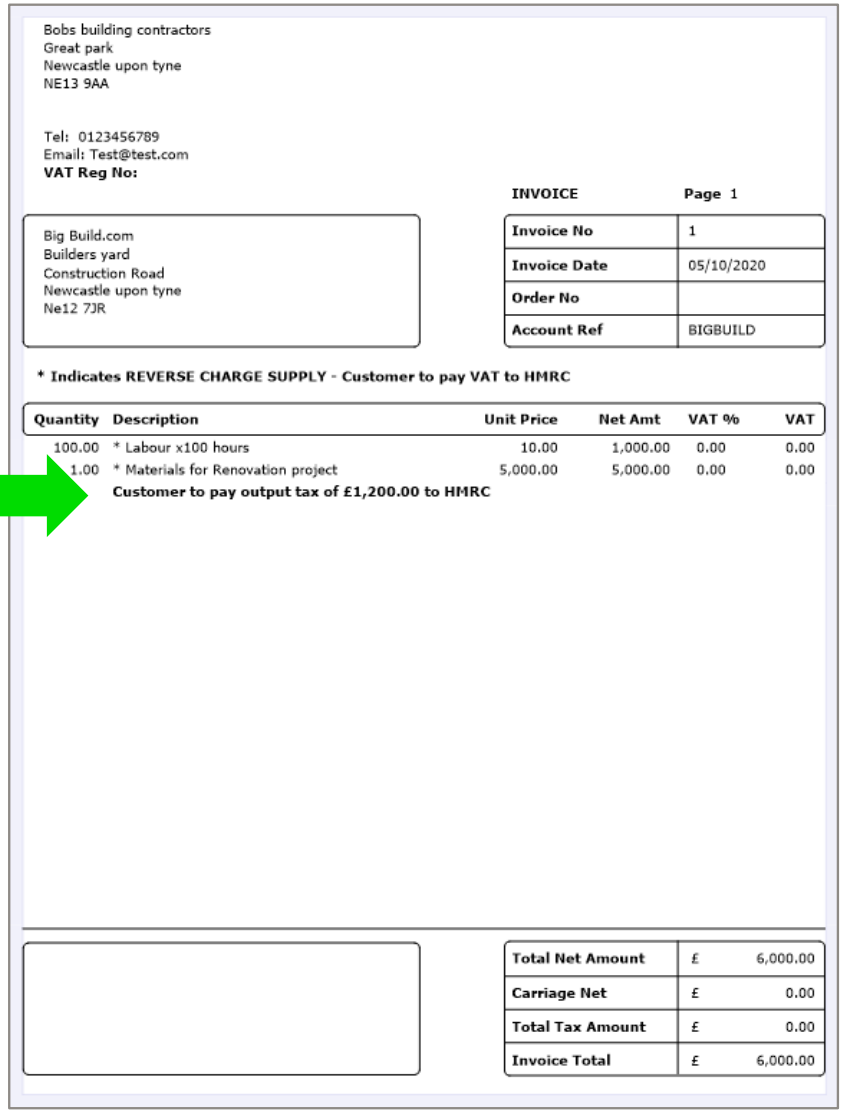
New layout wording on customer invoices

Our standard layouts have been configured to automatically display reverse charge supply on invoices.

It will also calculate the VAT without adding to the overall total of the invoice.



Bobs building contractors
Great park
Newcastle upon tyne
NE13 9AA

Tel: 0123456789
Email: Test@test.com
VAT Reg No:

INVOICE **Page 1**

Big Build.com
Builders yard
Construction Road
Newcastle upon tyne
Ne12 7JR

Invoice No	1
Invoice Date	05/10/2020
Order No	
Account Ref	BIGBUILD

*** Indicates REVERSE CHARGE SUPPLY - Customer to pay VAT to HMRC**

Quantity	Description	Unit Price	Net Amt	VAT %	VAT
100.00	* Labour x100 hours	10.00	1,000.00	0.00	0.00
1.00	* Materials for Renovation project	5,000.00	5,000.00	0.00	0.00

Customer to pay output tax of £1,200.00 to HMRC

Total Net Amount	£	6,000.00
Carriage Net	£	0.00
Total Tax Amount	£	0.00
Invoice Total	£	6,000.00

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Example 1
Incoming invoice from subcontractor

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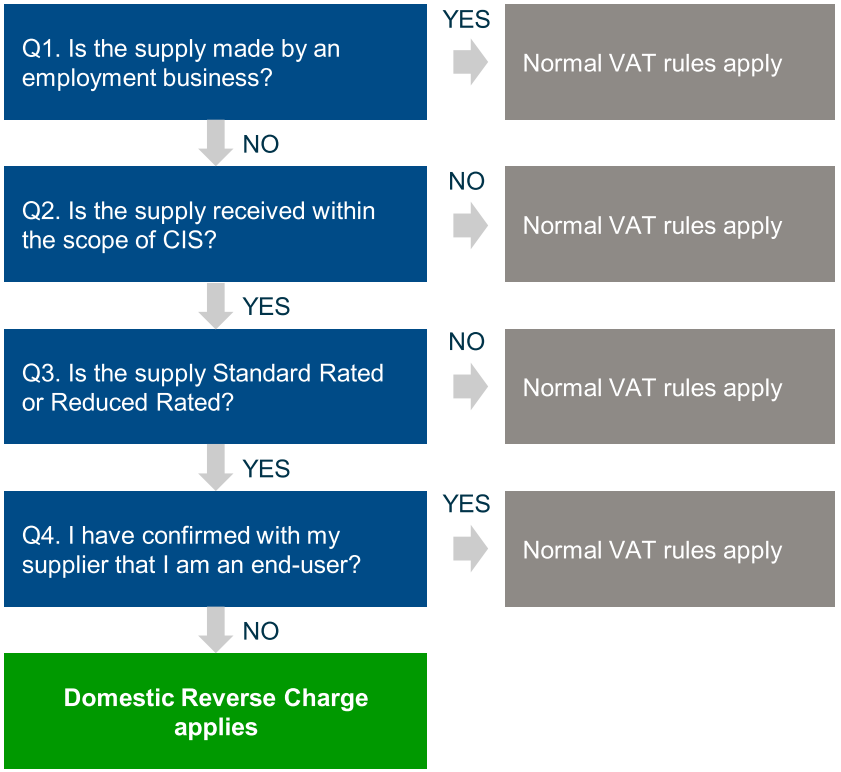
Example 1
Incoming supplier invoice where DRC applies

Example

- The supplier is invoicing you for the services which they have provided to you and they are:
  - VAT Registered
  - Supplying services subject to the Construction Industry Scheme
- The transaction has no VAT on it but needs to affect boxes 1, 4 and 7 of the VAT return
- Use the HMRC flowchart to help decide if CIS DRC applies



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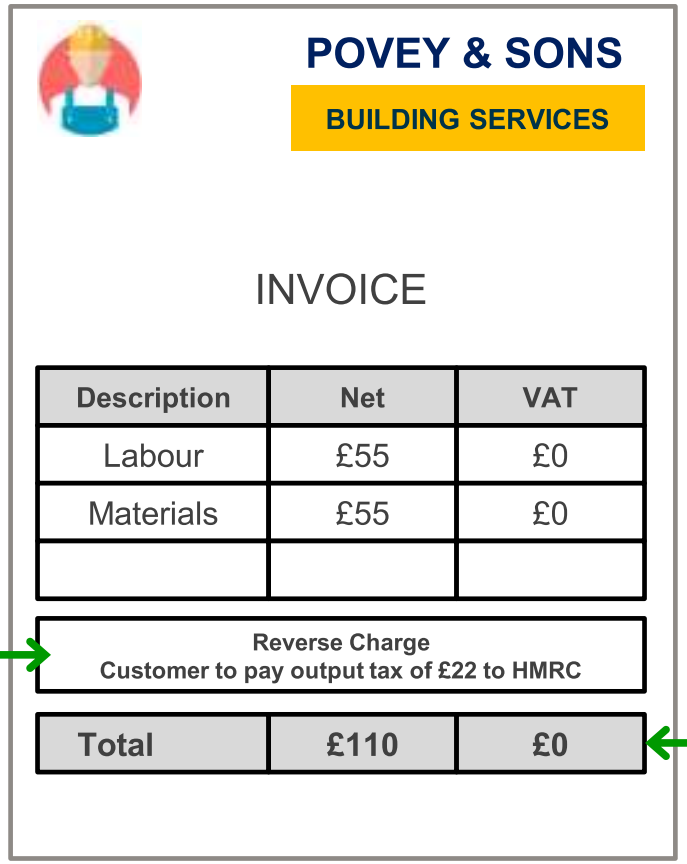
Example 1
Incoming supplier invoice where DRC applies

The subcontractor / supplier has invoiced us for work they have completed for us

They have indicated that the supplies are subject to reverse charge



The Notional VAT has been calculated but not added to the total of the invoice

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Example 2
Outgoing invoice to your main contractor

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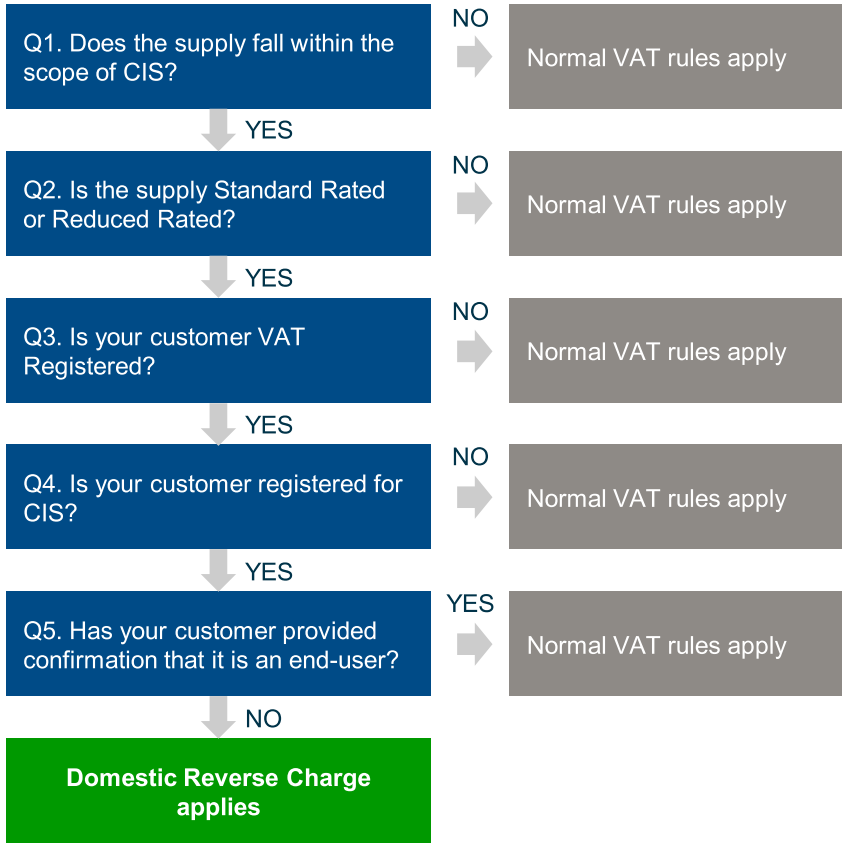
Example 2
Outgoing customer invoice where DRC applies

Example

- The customer you are invoicing for your services is:
  - VAT Registered
  - Not the end-users in the supply chain
  - Receiving services subject to the Construction industry scheme
- The transaction needs to affect box 6 only of the VAT return
- Use the HMRC flowchart to help decide if CIS DRC applies



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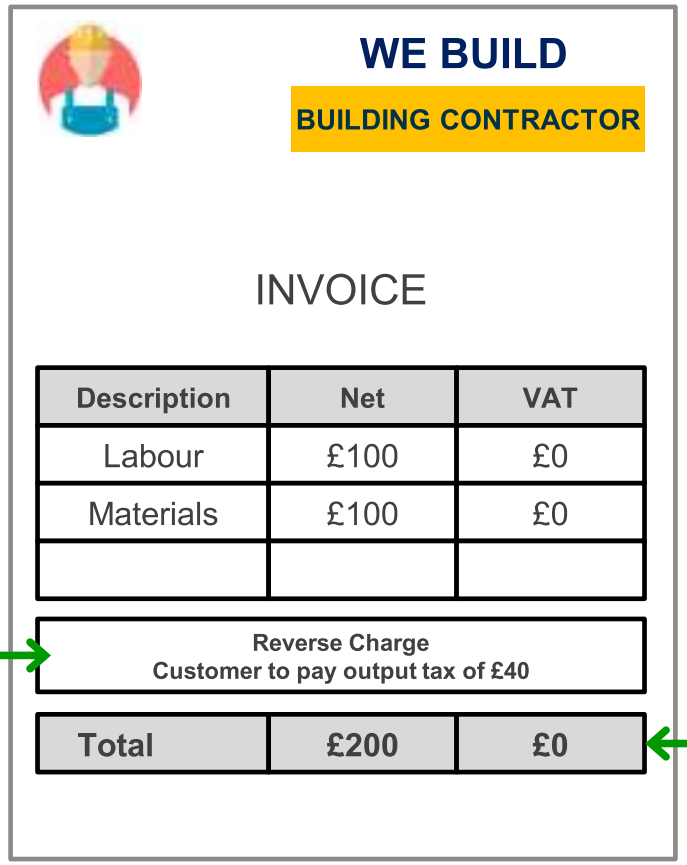
Example 2
Issuing a Domestic Reverse Charge invoice to your customer



They have indicated that the supplies are subject to reverse charge

The VAT has been calculated but not added to the total of the invoice

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Implementation

Supplier invoices

If a supplier invoice you are processing is subject to Domestic Reverse Charge

- Apply T21 for Standard Rated items
- Apply T26 for reduced rate items

Customer invoices

If a customer invoice you are producing is subject to Domestic Reverse Charge

- Apply T21 for Standard Rated items
- Apply T26 for reduced rate items
- Ensure the invoice clearly states the supply is subject to Domestic Reverse Charge

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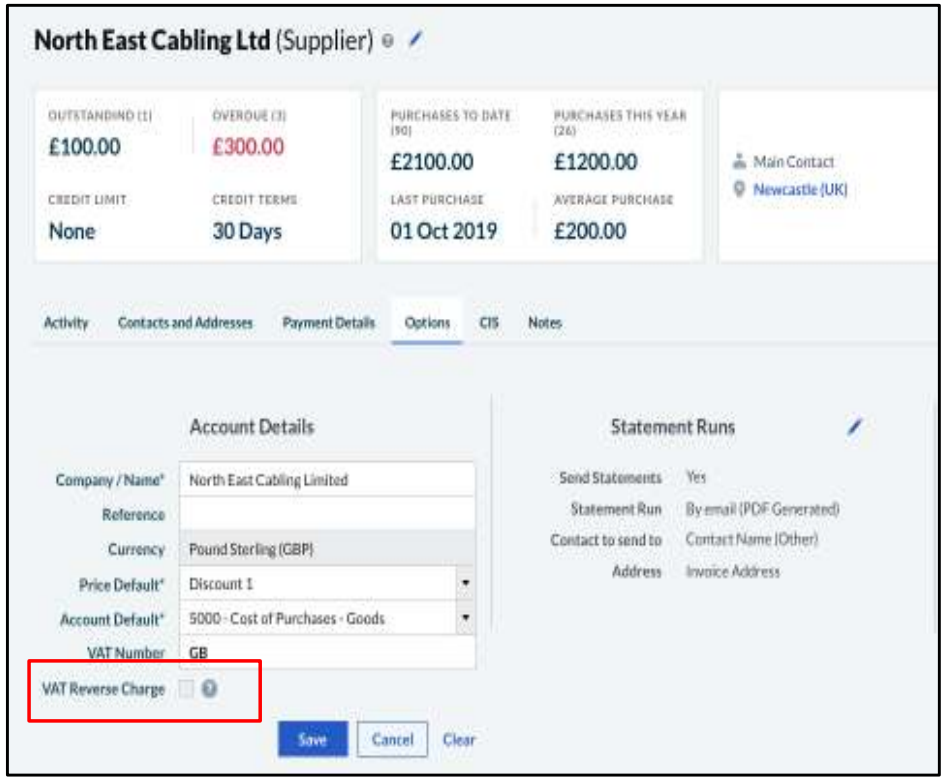
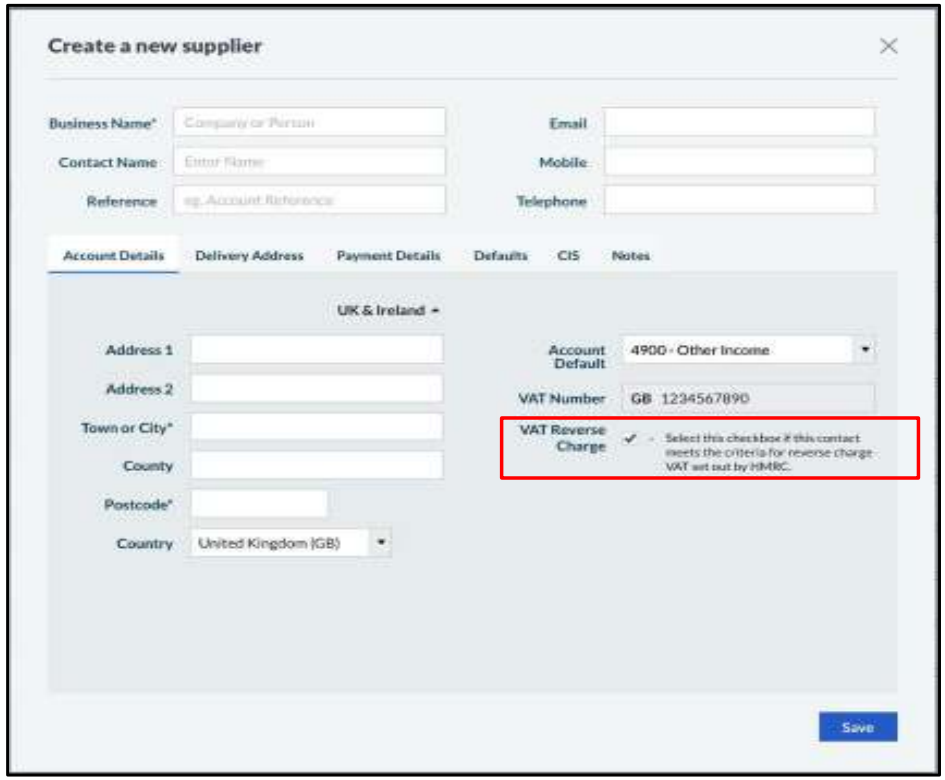
Example 1
Suppliers where DRC applies





Existing Suppliers

New suppliers

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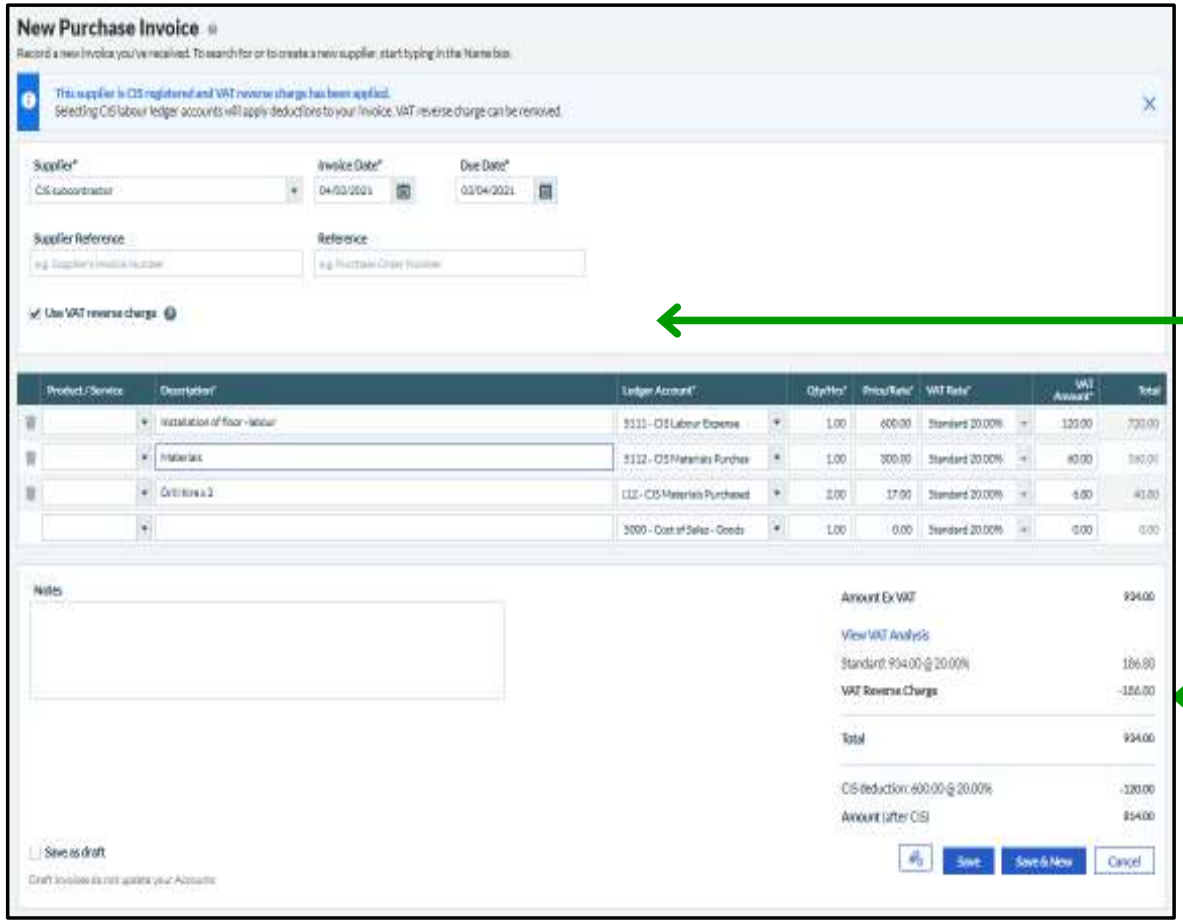
Example 1
Supplier invoice where DRC applies



When Creating a supplier/ subcontractor invoice you can specify if the invoice is reverse charge or not.

The Notional VAT has been calculated but not added to the total of the invoice

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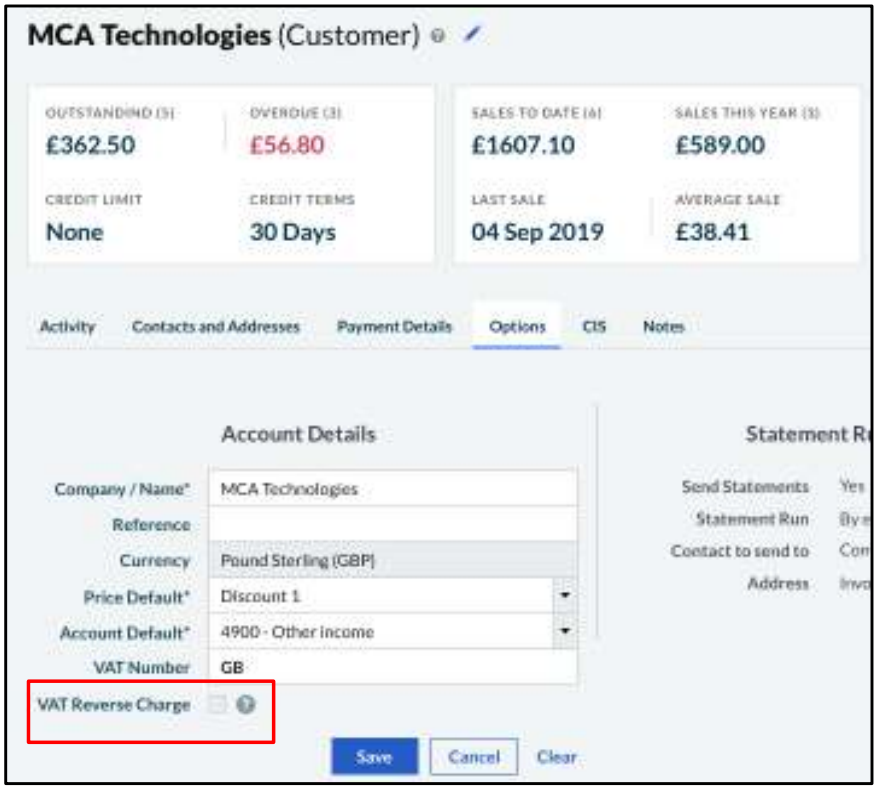
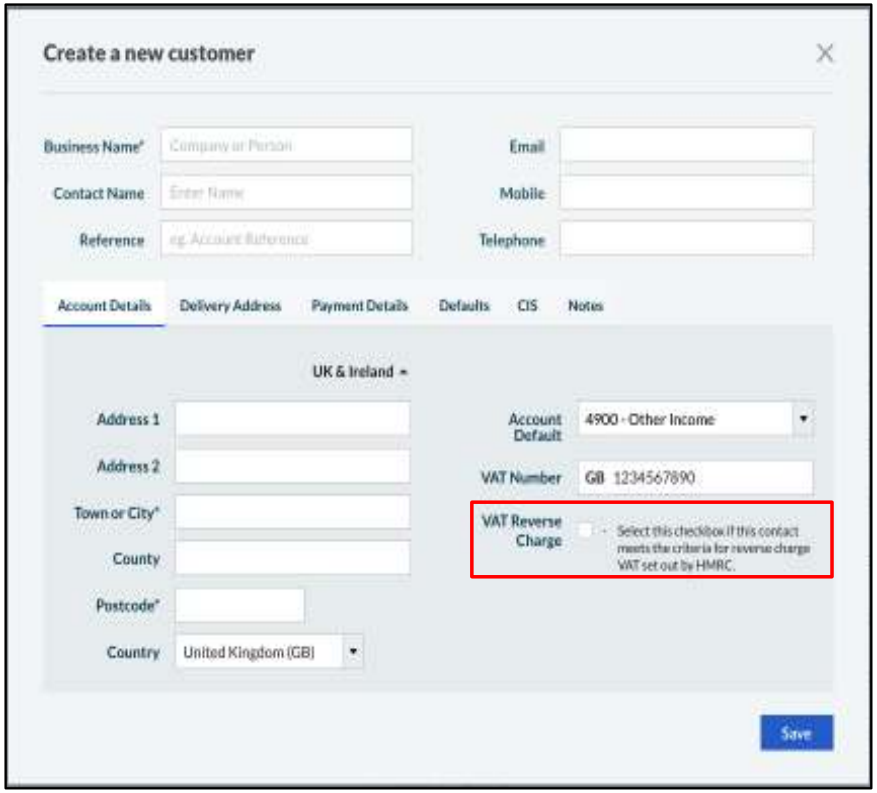
Example 2
Customers where Domestic Reverse Charge applies



Existing Customer



New Customer

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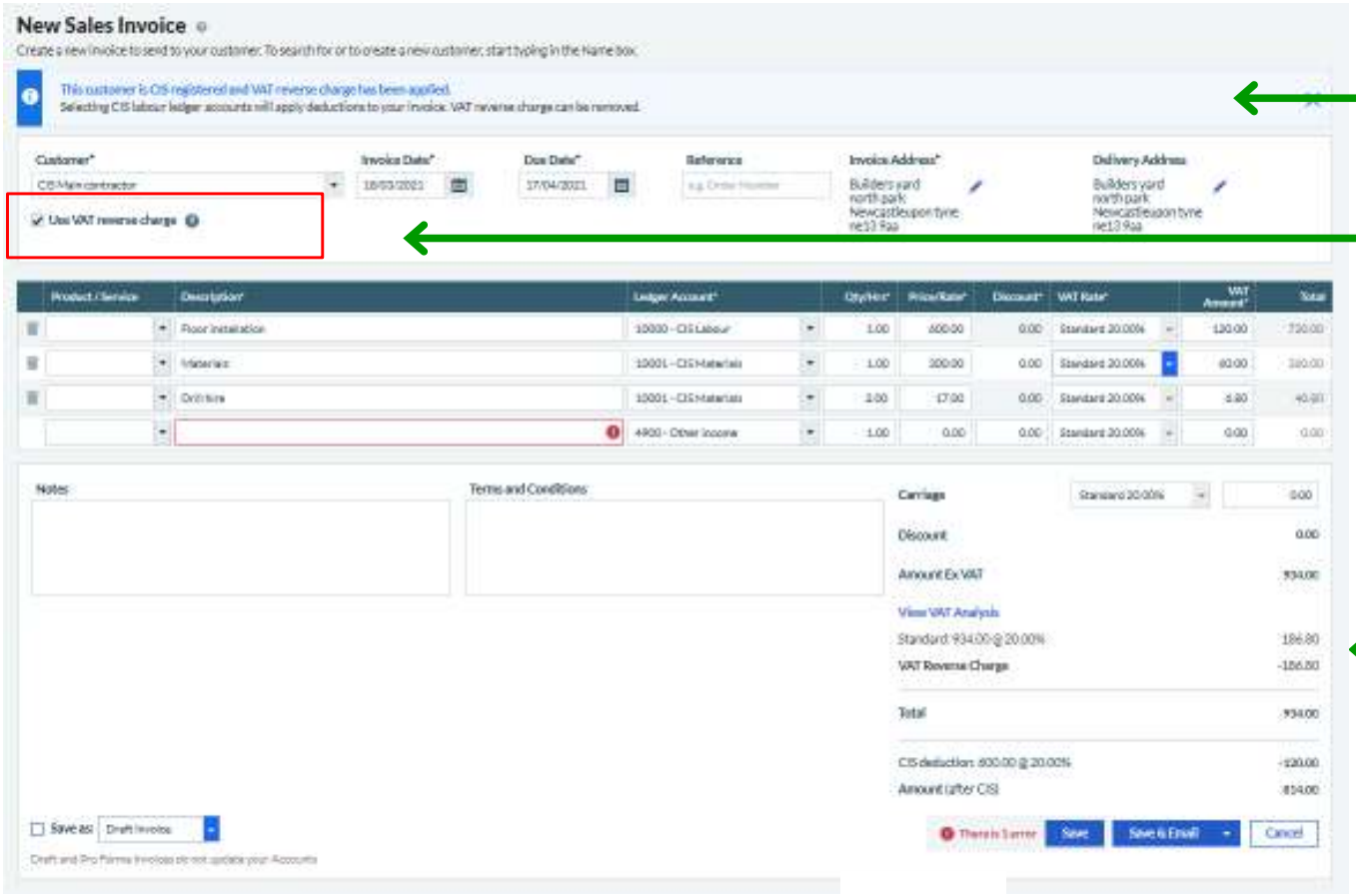
Example 2

Issuing a Domestic Reverse Charge invoice to your customer



New Banner wording

Reverse charge override

Reverse Charge calculated

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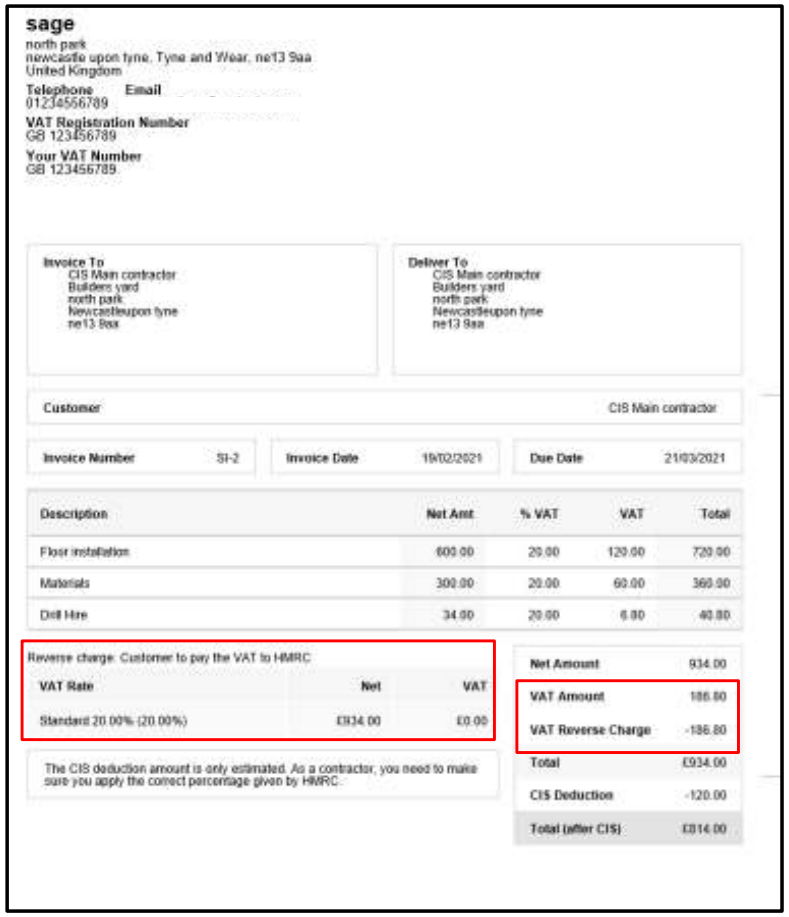
Example 2

Issuing a Domestic Reverse Charge invoice to your customer



sage
north park
newcastle upon tyne, Tyne and Wear, ne13 9aa
United Kingdom
Telephone 01234556789 Email
VAT Registration Number GB 123456789
Your VAT Number GB 123456789

Invoice To: CIS Main contractor, Builders yard, north park, Newcastleupon tyne, ne13 9aa
Deliver To: CIS Main contractor, Builders yard, north park, Newcastleupon tyne, ne13 9aa

Customer: CIS Main contractor
Invoice Number: SI-2 | Invoice Date: 19/02/2021 | Due Date: 21/03/2021

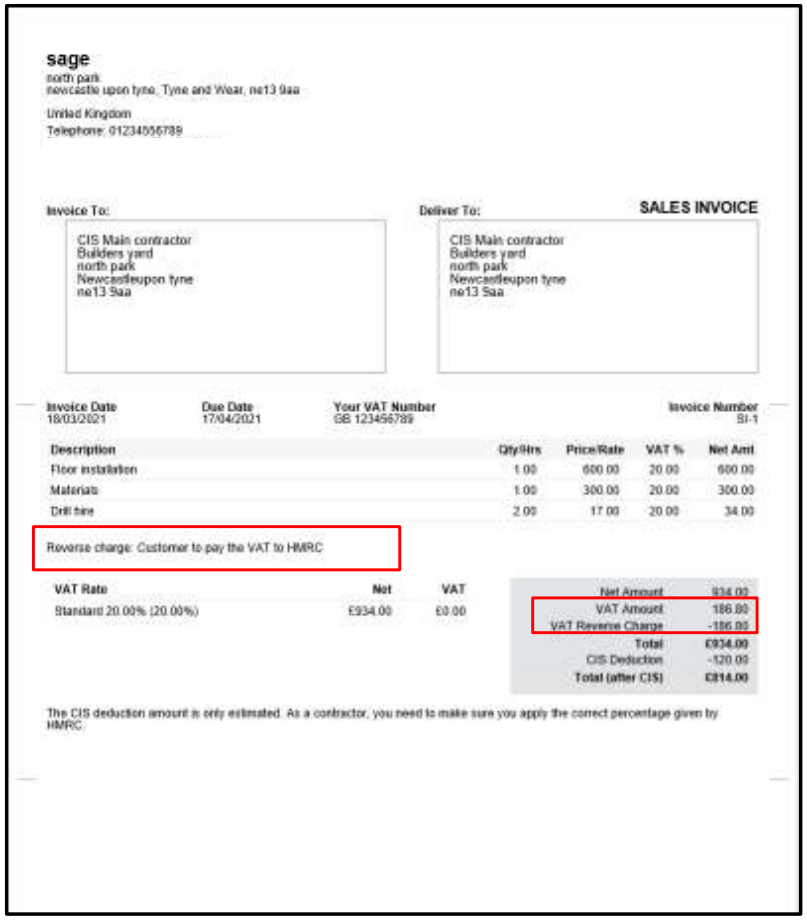
Description	Net Amt	% VAT	VAT	Total
Floor installation	600.00	20.00	120.00	720.00
Materials	300.00	20.00	60.00	360.00
Drill Hire	34.00	20.00	6.80	40.80

Reverse charge: Customer to pay the VAT to HMRC

VAT Rate	Net	VAT
Standard 20.00% (20.00%)	£934.00	£0.00

Net Amount	934.00
VAT Amount	186.80
VAT Reverse Charge	-186.80
Total	£934.00
CIS Deduction	-120.00
Total (after CIS)	£814.00

The CIS deduction amount is only estimated. As a contractor, you need to make sure you apply the correct percentage given by HMRC.



sage
north park
newcastle upon tyne, Tyne and Wear, ne13 9aa
United Kingdom
Telephone: 01234556789

SALES INVOICE

Invoice To: CIS Main contractor, Builders yard, north park, Newcastleupon tyne, ne13 9aa
Deliver To: CIS Main contractor, Builders yard, north park, Newcastleupon tyne, ne13 9aa

Invoice Date 18/03/2021 | Due Date 17/04/2021 | Your VAT Number GB 123456789 | Invoice Number SI-1

Description	Qty/Hrs	Price/Rate	VAT %	Net Amt
Floor installation	1.00	600.00	20.00	600.00
Materials	1.00	300.00	20.00	300.00
Drill hire	2.00	17.00	20.00	34.00

Reverse charge: Customer to pay the VAT to HMRC

VAT Rate	Net	VAT
Standard 20.00% (20.00%)	£934.00	£0.00

Net Amount	934.00
VAT Amount	186.80
VAT Reverse Charge	-186.80
Total	£934.00
CIS Deduction	-120.00
Total (after CIS)	£814.00

The CIS deduction amount is only estimated. As a contractor, you need to make sure you apply the correct percentage given by HMRC.

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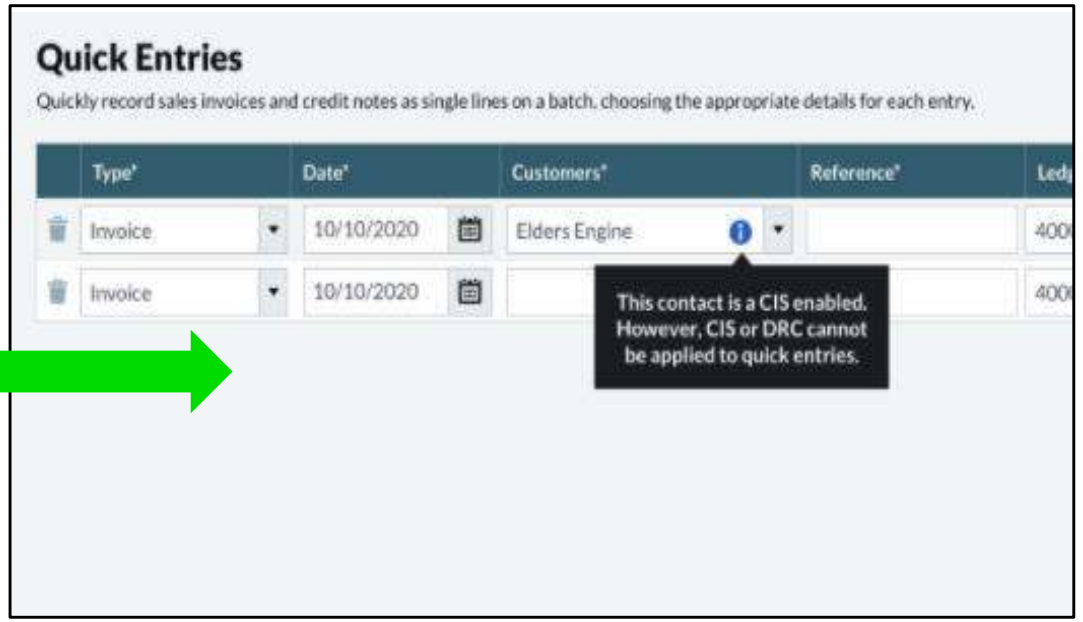
Additional considerations for processing DRC on Sage Business Cloud Accounting.

Users can create recurring invoices with Domestic Reverse Charge.

Existing recurring invoices should be reviewed after March 1st to ensure the correct VAT is applied.

Domestic Reverse Charge cannot be applied to quick entries.



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Summary

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Preparation

Businesses should:

- Review supplies made to and received from other VAT Registered contractors to establish if these are subject to reverse charge
- Consider the changes to your accounting system to deal with this change and ensure you are using the correct version of your software
- Consider the Cash flow impact to your business

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Salary and Supplier Payments

Powered by Modulr

sage

FAQs

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Frequently Asked Questions

What if my invoice contains materials AND labour?

If materials are used as part of the supply of services then the reverse charge will apply. This is different to the CIS scheme where materials are specifically excluded from calculations.

There can be exceptions to this such as the 5% disregard so please check the HMRC guidance on this

https://whttps://www.gov.uk/guidance/vat-reverse-charge-technical-guide

What if I use VAT Cash Accounting or Flat Rate VAT?

Transactions subject to the reverse charge should be excluded from the cash accounting scheme and from the flat rate scheme.

Users of the Flat Rate Scheme will have to consider if it's still beneficial to them bearing in mind that under the scheme they cannot recover VAT incurred on purchases of materials, overheads and so on.

https://whttps://www.gov.uk/guidance/vat-reverse-charge-technical-guide

What if my project spans the 1st of March?

For invoices issued for supplies that span the 1st March 2021, the tax point needs to be considered

- If the tax point falls before 1st March 2021 then normal VAT rules apply
- If the tax point falls after 1st March 2021 then Domestic Reverse Charge rules will apply
- To understand the tax point rules see here

https://www.gov.uk/vat-record-keeping/time-of-supply-or-tax-point

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Further support and training

- On Demand webinar recording
- Sage University FREE eLearning
- Sage Help Centre

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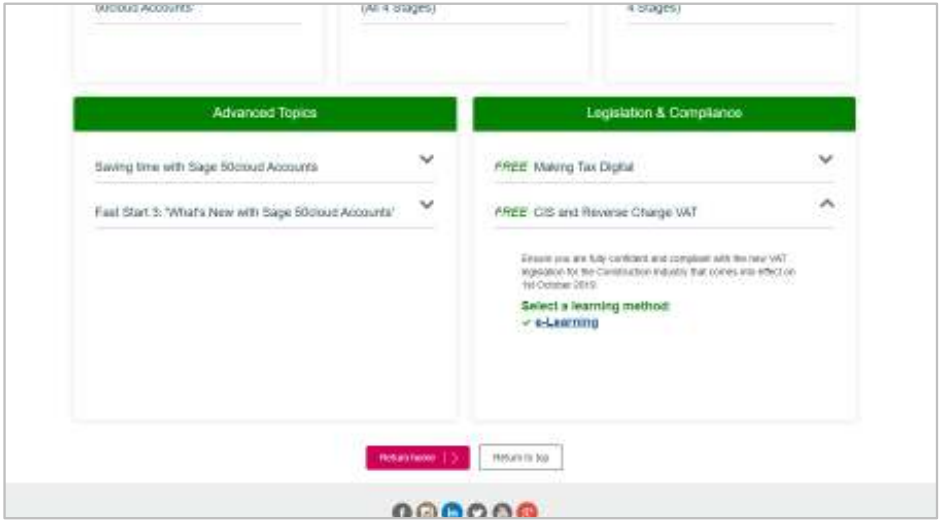
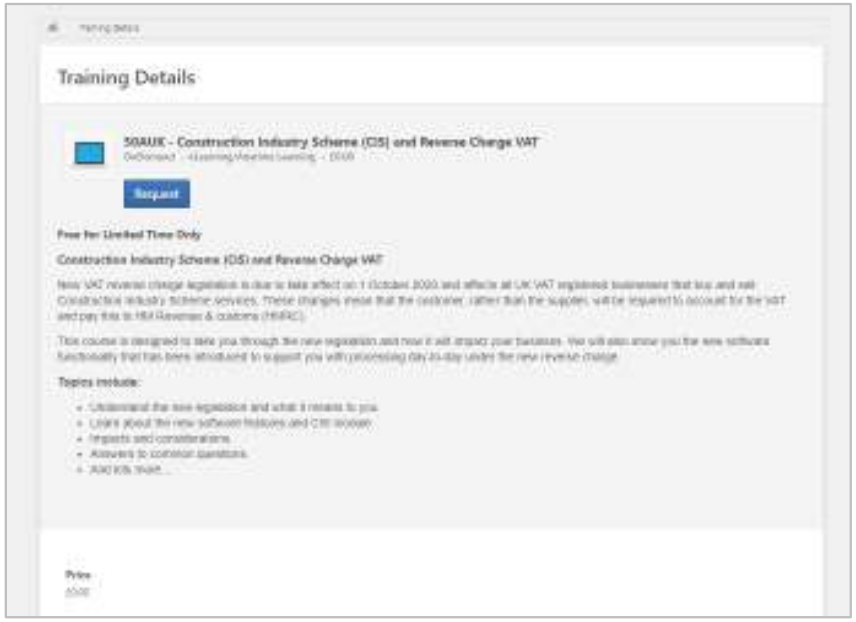
Further support and training

Sage University FREE eLearning

- www.sageU.com/uki
- 100's free eLearning courses covering all products
- Dedicated module for CIS Domestic Reverse Charge





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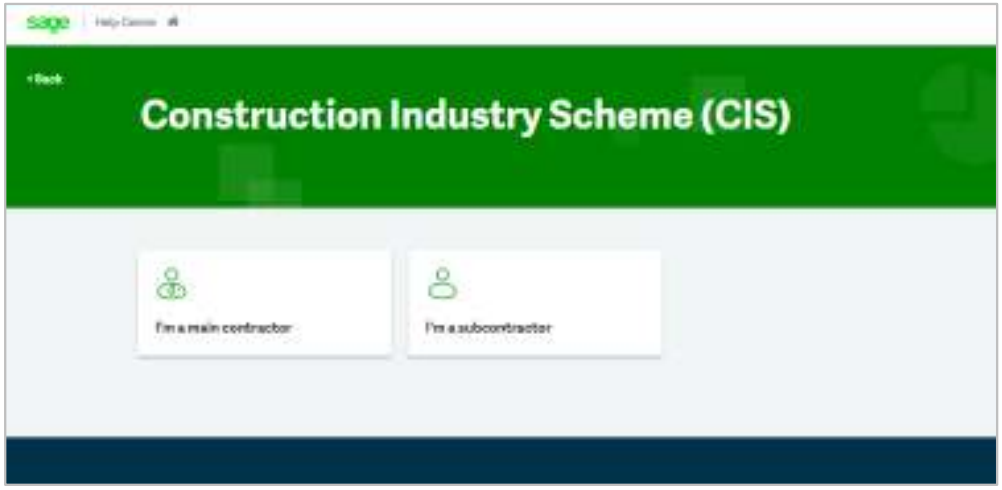
Further support and training

Sage Help Centre

- www.sage.co.uk/help
- Our central hub for all help and support content
- Search our knowledge base for help on any topic



Sage Help Centre – CIS Page

- https://my.sage.co.uk/public/help.aspx#/customer/support/accounts/category/cis
- Our central hub for all help and support content
- Search our knowledge base for help on any topic

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