

SPOTLIGHT ON THE CONSTRUCTION INDUSTRY SCHEME



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VAT 'reverse charge' process to apply in construction sector

Under the reverse charge process, it is the customer, rather than the supplier, who accounts directly to HMRC for VAT on a supply. HMRC considers that such a mechanism helps to deter 'Missing Trader' fraud (where a supplier charges output tax to its customer but fails to account to HMRC for the VAT collected). They consider that such fraud in construction sector labour supply chains presents a significant risk to the Exchequer and consequently, a reverse charge mechanism for 'specified services' is to be introduced on 1 October 2019.

From the above date, it will be a contractor's responsibility (assuming that he is VAT-registered) to account for output VAT on the value of the services of any VAT registered subcontractor. The contractor will also treat the same amount of VAT as his input tax and will be able to recover it in full if making only taxable supplies. Hence, for the contractor, the process will normally have no VAT cost. The subcontractor should no longer charge VAT on its supplies to the contractor – if it purports to do so, the contractor should refuse to pay the supposed VAT amount. It should also be noted that the reverse charge rules will only apply to contractors and there is no requirement for the final customer in the chain to apply a reverse charge process. But the measure could potentially affect a developer who, for example, sells part of a site to a housing association for whom he then acts as contractor.

Although the subcontractor will no longer be charging VAT on supplies to the contractor, he is still making taxable supplies and is therefore entitled to recover the VAT incurred on his own costs.

The reverse charge process will apply to 'specified services' provided by the subcontractor – such services will be those that are defined as 'construction operations' for the purposes of the

Construction Industry Scheme, although there will of course be an exception for zero-rated supplies (where there is no VAT to account for anyway). The measure will also apply to the value of any goods which are supplied in conjunction with the specified services and which fall to be treated as part of a single supply of services.

The measure could result in adverse commercial implications for subcontractors. There will be a negative cashflow impact because the subcontractor will no longer be holding amounts of VAT until the next VAT return. Additionally, the subcontractor's VAT returns are now likely to be repayment returns which may be queried by HMRC, thus exacerbating the cashflow issue. Finally, any subcontractor using the Flat Rate Scheme will be disadvantaged because their VAT liability is a fixed percentage of their gross income, whether or not VAT has been charged to the customer.

The introduction of the reverse charge process will require changes to accounting systems, and so the provisions have been announced well in advance to allow the maximum time for this. It is just unfortunate that businesses are having to cope with the small matter of changes arising from Brexit and with Making Tax Digital at the same time!



The Construction Industry Scheme (CIS) – contractors and penalties

CIS is a special set of rules that applies to all businesses, be they sole trader, partnership or limited company operating, within the UK construction industry.

It also applies to 'non-construction' businesses, which usually spend, on average, more than £1 million a year on construction operations over a three-year period.

The scheme is a minefield of regulations and if you fail to comply, the penalties can be substantial, for example:

EMPLOYMENT STATUS

On your return, you must declare that the subcontractors listed are not employees. You could get a penalty of up to £3,000 if you give the wrong employment status for a subcontractor on your monthly return.

MONTHLY RETURNS

If you file your monthly return late, HM Revenue and Customs (HMRC) will send a late filing penalty notice telling you how much to pay:

If the return is	Penalty
1 day late	£100
2 months late	£200
6 months late	£300 or 5% of the CIS deductions, whichever is higher
12 months late	£300 or 5% of the CIS deductions, whichever is higher



For returns later than this, you may be given an additional penalty of up to £3,000 or 100% of the CIS deductions on the return, whichever is higher.

If you have not paid any subcontractors in the previous tax month, remember to tell HMRC by the 19th of the month that no return is due. If you do incur a penalty, once you notify HMRC that no subcontractors were paid in the month, HMRC will cancel the penalty.

PAYING DEDUCTIONS TO HMRC

You must pay HMRC any deductions you have made by the 22nd (or the 19th if you are paying by post). If you do not pay on time or in full, you will be charged a penalty and interest at a daily rate too.

RECORDS FOR INSPECTION

If you fail to produce records relating to payments made under the scheme when asked to do so, HMRC may charge penalties of up to £3,000.

However, help is at hand and only a phone call away... if you would like any advice or support with CIS, or wish to join our Tax Investigation Service, please do not hesitate to contact a member of our team.





Landlords caught out by interest restriction rules

The 2017/18 tax year saw the commencement of restrictions to relief for finance costs of residential property. As tax returns begin to be prepared and filed for this period, we take a look at some unexpected results when applying the new rules.

TAXABLE INCOME

Under the new rules, the tax is first calculated based on the property profits excluding any restricted finance costs.

A subsequent calculation is then carried out to apply a tax reducer at 20% (i.e. the basic rate) of the allowable finance costs. As the finance costs are initially ignored altogether, this will lead to higher taxable income reported for landlords with property debt. The impact of this could include:

- basic rate taxpayers being tipped into the higher rate of tax;
- tipping income above £100k/£150k leading to a reduction in personal allowance or pensions allowance respectively; or
- tipping income above £50k leading to a reduction or loss of child benefit

THE 'TAX REDUCER'

Once the property income has been taxed, a tax reducer is calculated and applied. This is not, however, just 20% of the restricted finance costs.

It is instead calculated as 20% of the lower of:

- total adjusted income (which excludes savings and dividend income and is after deduction of personal allowance);
- total adjusted rental profits (i.e. rental profits excluding restricted finance costs); and
- restricted finance costs.

This calculation could lead to some strange results.

For example, a director of an owner-managed business receiving a low salary of, say, £8,000, dividends of £20,000 and rental profits of £30,000 (before finance costs)

of £3,000 would have a figure of nil under 'total adjusted income' and would, therefore, not receive any tax reduction in the current year for the restricted costs. Instead, these costs would be carried forward for potential use in future years.

ACTION TO TAKE

The impacts may not be significant for 2017/18 as only 25% of finance costs will be restricted, as described above. It would be worthwhile, however, looking at the position as at 2020 once the rules are fully phased in.

Planning opportunities could also be explored to help mitigate the effects, such as spousal transfers, partnerships and incorporation of the property business. Please speak to a member of the tax team if you would like further information on this.

Property businesses are characterised by high risks and great rewards.

Whether you are a property developer, investor, agent, or in the construction industry, you need professional support if you want to steer a prudent, profitable path through the complexities of legislation and financial risk to ultimate sale or exit.

UNDERSTANDING YOU

At Hazlewoods, our property accountants work with you to help you decide what service you need.

You have access to a comprehensive business support package, regardless of the size of your business.

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