

# Construction Land and Property Bulletin

December 2018



The construction, land and property sector is a crucial part of the local and national economy in the UK. It is a large and complex sector which is subject to regulation and political influence.

As the economic and political landscape continues to evolve, so will the sector. From shortages of labour and increasing materials costs, to sale prices and local and regional planning obstacles, there are many challenges for businesses to overcome.

## VAT - Reverse charge for construction services

Draft legislation and guidance has been issued regarding the implementation of the Domestic Reverse Charge ("DRC") for certain construction services.

The intention is for the DRC to apply to certain supplies made on or after 1 October 2019. The DRC is an anti-avoidance measure to prevent revenue loss from chains of transactions within the construction sector. HM Revenue and Customs (HMRC) have said that more detailed guidance will be published during the run-up to 1 October 2019.

### Supplies that will be affected

The DRC will only affect supplies at the standard or reduced rates where payments are required to be reported through the Construction Industry Scheme (CIS).

Therefore supplies between sub-contractors and contractors, as defined by CIS, will be subject to the reverse charge unless they are supplied to a contractor or deemed contractor who is an end user.

End users will usually be recipients who use the building or construction services for themselves, rather than sell the services on as part of their business of providing building or construction services.

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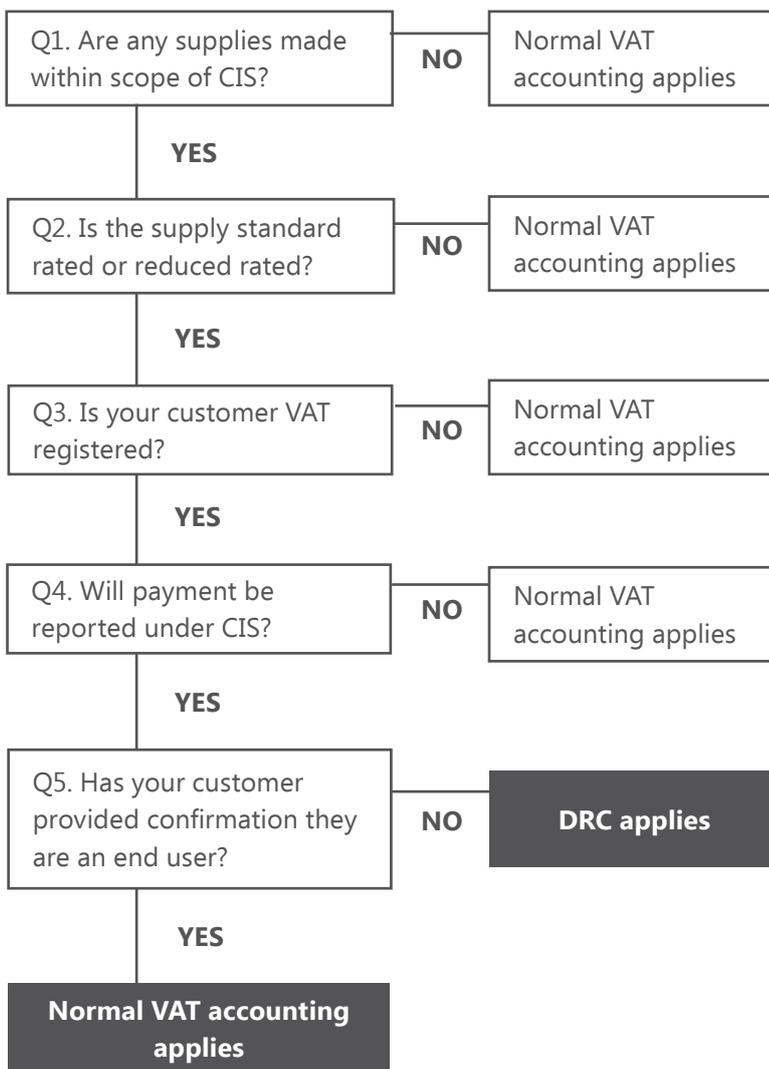
The legislation enables those connected to end users, including landlords or tenants, to also be treated as end users. Therefore intra-group and leasing re-charges of building and construction services connected to the end user should be excluded from the DRC.

## How a DRC operates

As the name suggests, a DRC means that the customer receiving the supply of specified construction services accounts for the VAT due rather than the supplier (the reverse of the normal accounting procedure). In addition, the customer can deduct up to 100% the VAT due on the supply as an input, which can result in no net tax payable to HMRC.

HMRC has introduced similar measures for mobile telephones, emissions allowances, gas, electricity and electronic communications. A domestic reverse charge only applies to supplies between UK taxable persons (i.e. those registered for UK VAT) therefore unless the customer is registered or liable to be registered for VAT, it will not apply.

The flowchart below is to help suppliers of building and construction services assess whether the DRC should apply.



## Implementation of the DRC

HMRC has said that it will apply a “light touch” in dealing with related errors that occur in the first 6 months after introduction, where businesses are trying to comply with the new legislation. Details of this “light touch” have yet to be seen.

However, their view remains that businesses that knowingly claim incorrect end user status will still be liable for the output tax that should have been paid and may be liable for penalties.

## Scope of the DRC

Because it only applies to supplies where payments are reported through CIS, the supplies affected are closely aligned to those defined as construction operations under CIS.

It applies to the following services which would normally be subject to standard or reduced rates of VAT:

- construction, alteration, repair, extension, demolition or dismantling of buildings or structures (whether permanent or not), including offshore installations
- construction, alteration, repair, extension or demolition of any works forming, or to form, part of the land, including (in particular) walls, roadworks, power-lines, electronic communications apparatus, aircraft runways, docks and harbours, railways, inland waterways, pipe-lines, reservoirs, water-mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence
- installation in any building or structure of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection

- internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration
- painting or decorating the internal or external surfaces of any building or structure

It also applies to services which form an integral part of, or are preparatory to, or are for rendering complete, the services described above; including site clearance, earth-moving excavation, tunnelling and boring, laying of foundations, erection of scaffolding, site restoration, landscaping and the provision of roadways and other access works.

## Exclusions

Supplies of the following supplies are not covered by the DRC if supplied on their own:

- drilling for, or extraction of, oil or natural gas
- extraction (whether by underground or surface working) of minerals and tunnelling or boring, or construction of underground works, for this purpose
- manufacture of building or engineering components or equipment, materials, plant or machinery, or delivery of any of these things to site
- manufacture of components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or delivery of any of these things to site
- the professional work of architects or surveyors, or of consultants in building, engineering, interior or exterior decoration or in the laying-out of landscape
- the making, installation and repair of artistic works, being sculptures, murals and other works which are wholly artistic in nature
- sign writing and erecting, installing and repairing signboards and advertisements
- the installation of seating, blinds and shutters
- the installation of security systems, including burglar alarms, closed circuit television and public address systems

HMRC have pointed out that this list is not exhaustive and if these or any other non-reverse charge supplies are supplied with supplies subject to the DRC the mixed supplies section below applies.



## Mixed supplies

The legislation is designed so that if there is a reverse charge element in a supply then the whole supply will be subject to the DRC. This is to make it simpler for both supplier and customer and to avoid the need to apportion or "split out" the supply.

In addition, if there has already been a DRC supply on a construction site, if both parties agree, any subsequent supplies on that site between the same parties can be treated as DRC supplies. HMRC sees this as a means of reducing doubt and speeding up the decision making process for both parties.

HMRC have said that if still in doubt, provided the recipient is VAT registered and the payments are subject to CIS, it is recommended that the DRC should apply.

## End users

End users are those who receive building and construction services but do not supply those services along with other building and construction services. Under CIS rules, they are required to report their payments to HMRC because they are 'deemed contractors', either because they are named in the legislation or because of the number of purchases of building and construction services they make.

Payments by deemed contractors can be excepted from reporting through CIS, so the DRC will not apply. Suppliers may be unaware they are supplying an end user, and it will be up to the end user to make the supplier aware of this fact, and that VAT should be charged in the normal way.

This should be in a written form that is clearly understood and can be retained for future reference. Although HMRC have not provided a template for this there is a draft example in Annexe 1.

If the end user does not provide its supplier with end user status information it will still be responsible for accounting for the DRC.

If you are a deemed contractor, especially when the project is a mixed supply, you should advise your supplier that the DRC will not apply. This should prevent confusion as to whether the DRC is applicable to a supply which may in part be zero-rated and any DRC derived output tax is not recoverable as the new dwellings are to generate exempt income.

We will provide further details, including the practical aspects (completing VAT returns, invoicing, tax points, etc.) nearer the time of implementation.

## Annexe 1

### Draft declaration of end user status to supplier.

	End User Ltd End User House End User Industrial Estate Anytown AN1 1YT
CIS Supplier LTD CIS House CIS Industrial Estate Everytown EV1 1ER	
Dear Sir/Madam	
<b>Re: End User Ltd</b>	
This letter is to confirm that End User Limited is, for the purposes of the domestic reverse charge legislation for construction supplies, an end user as per the definitions in the said law.	
Therefore, the supplies made to End User Limited are not subject to the domestic reverse charge but should be subject to VAT as per a normal supply.	
We would be grateful for you to acknowledge this letter in writing for our records.	
Regards	

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## VAT Tribunal - no windfall

The taxpayer erred in making zero-rated supplies of sub-contract work to a main contractor. Whilst the building was a relevant charitable purpose ("RCP") building, the zero-rating only applies to supplies made to the entity using the building for RCP, i.e. those of the main contractor.

When HMRC identified the error, the main contractor had gone into liquidation so the VAT due on the supplies could not be reclaimed by the main contractor, nor paid to the sub-contractor. Therefore, the sub-contractor argued the raising of an assessment by HMRC would create an unjust enrichment windfall for HMRC as there would be no corresponding claim by the recipient of the supply. The Upper Tribunal ruled that this was not the case, and said that the initial error could not be fixed by a claim for fiscal neutrality.

Whilst the views of the Tribunal may appear oblique, the case raises the issue of ensuring that the right VAT liability is applied at the time of supply. Many think "if we charge at 20% that'll be safest" when it often creates issues for the recipient. You should always seek VAT advice when you are unsure.

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## Unfulfilled supplies - change for VAT treatment

HMRC have just published a Brief setting out the changes to the VAT treatment for payments on unfulfilled supplies.

This will mainly affect the hotel sector where retained deposits from cancellations are currently treated as compensation and thus outside the scope of VAT. The law is to be changed so that from 1 March 2019 where payment has been retained but no corresponding supply made, the VAT due at the time the payment was made is still due, unless there is a refund to the customer.

However, for any business post 1 March 2019, where payment has been made but the relevant supply was not, VAT will be due.

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## Investment properties and trading groups

We often see trading businesses investing in property. This can start with their own trading property but can extend to developing a portfolio of others as a way of generating a return outside of their trading activities. If the business has the cash or the ability to borrow to allow such investment, it can be beneficial as additional income, as well as providing an opportunity to benefit from the capital growth. However, if not carefully planned and structured, there can be pitfalls for the business and its owners.

Here we look at some aspects of this in further detail.

### Available reliefs

Generally speaking, shares in an unlisted trading company can qualify for Business Property Relief (BPR) in the event of a shareholder's death, providing the shares were held for two years prior to death and the business is seen as trading. Further detail of which is discussed below. This means that the value of the shares do not form part of that individual's estate and are not subject to Inheritance Tax ("IHT").

Alternatively, if shares held in a trading company or group were to be sold, the chargeable gain on the sale of these shares could qualify for Entrepreneurs Relief ("ER") provided that the following conditions are met:

- The shareholder holds at least 5% of the shares AND voting rights.
- That individual is either an employee or Director.
- The company or group is "trading".
- The above criteria has been met continuously for at least twenty four months immediately prior to the sale of the shares. This has recently changed from a twelve month qualifying period.

The individual must also not exceed their qualifying lifetime gains limit of £10m. ER will not be available on gains over and above this limit.

Qualification for ER would mean that the chargeable gain on the sale of the shares is taxed at 10% rather than 20% for higher rate tax payers.

### Company trading status

The two reliefs outlined above are available for shares in trading companies or holding companies of a trading group. The 'trading' status however, is thrown into doubt if there is seen to be substantial investment activity within the company or group.

The definition of trading is different for the two reliefs, as outlined below:

### Entrepreneurs relief

HMRC interprets 'substantial' as being no more than 20% of:

- gross assets
- income from the investment activities
- expenses incurred or time spent in understanding these activities

Investment activities normally include income generated from the letting of investment property to third parties.

Each of these indicators will be considered when assessing the weighting of the investment activity, rather than considering each one as an individual test. The company's history will also be considered. So if 40% of a company's balance sheet was made up of investment property which is let to a third party, this does not necessarily mean the reliefs are lost, if the income is only 2% of the overall income and minimal time is spent running the properties.

There are some instances where income from the letting of properties may not be viewed as investment activities. For example; when properties are let which were previously held as trading premises, providing the intention is to sell the property.

## Business Property Relief

For BPR, the trading status is lost when a company is deemed to be dealing wholly or mainly in investment activities.

The 'mainly' requirement means that prohibited land or investment activities will prevent BPR being available where they account for more 50% of the total business operations. In determining whether a business qualifies for BPR, it is necessary to look at the nature of the business activities 'in the round' and consideration must be given to:

- overall context of the business activities
- relevant capital employed
- time spent by employees
- level of turnover

As with Entrepreneurs Relief, no single factor should determine the nature of the business and each one should be considered as an overall weighting.

For group companies, where any subsidiaries are held that are deemed 100% investment companies e.g. their only activity is the rental of investment property to a third party, BPR is restricted to the value of only the trading companies within the group. For corporate groups that hold and lease properties for trading use by their fellow group members (intra group letting), there is no BPR restriction.

The conclusion as to trading status in each scenario is therefore not black and white and all elements need to be considered when drawing conclusions. For any planned sale of shares, advance clearance can be obtained from HMRC as to whether they deem the company or group to be trading.

## Planning

Careful consideration and planning must be given to any scenario where investment property is held either within a company or group.

Holding investment property companies within a group can be beneficial, for example with the utilisation of any losses made against group company profits (working both ways). For the purposes of BPR, integrating properties within trading companies rather than having separate investment companies can sometimes protect the trading status. However, in some instances such structures can also put the group at risk if investment activity is deemed to be too high.

One common pitfall can be for the business trading property (which is not the same as an investment property) to be held outside of the group. Whilst there are associated disposal rules which can come into play in certain ownership scenarios with regards to Entrepreneurs Relief, if the property is sat within a separate investment property company outside of the group, there are no such provisions. In this scenario the trading property is also not being protected from IHT by sitting outside the group.

When it comes to purchasing investment property, advance planning can help mitigate potential negative tax consequences. For example; a new company can be set up in a tax efficient manner e.g. including children as the shareholders. For existing companies that hold property or groups with investment company subsidiaries, there are steps that can be taken to extract this property into a new company/structure which can reduce the risk of losing the trading status (and therefore tax breaks) of genuine trading businesses. Careful planning should also be considered for the purchase of trading properties, to avoid scenarios as outlined above.

Proper and timely tax planning is therefore key when it comes to property and trading companies. Our Property team are more than happy to talk to you about your existing structure or any new ventures with the above points in mind.

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# CIS Factsheet for Contractors

## Contractors

If you pay subcontractors for construction work, or spend more than £1 million a year on construction in any 3-year period, then you must register as a contractor with HMRC. Contractors have additional responsibilities to follow and it is important that these responsibilities are understood in order to avoid penalties from HMRC.

## The main responsibilities of a contractor

### Identifying a subcontractor:

Contractors are responsible for identifying when they have gone into contract with a subcontractor (Please refer to the HMRC website for examples of subcontractors which fall within the scope of CIS -<https://www.gov.uk/what-is-the-construction-industry-scheme>). This is important as some subcontractors must have deductions made from their payments. Contractors must verify subcontractors with HMRC in order to determine the appropriate rate of deduction to use.

### Verifying a subcontractor:

In order to determine the rate of deduction to use on payments, new subcontractors must be verified with HMRC. The verification process must be done before payments are made, in order to avoid paying subcontractors the incorrect amount. You can verify subcontractors by using the HMRC CIS online service. The details you will need to obtain from subcontractors are as follows:

- their 10 digit unique taxpayer reference (UTR)
- National Insurance number if they're a sole trader - you can't verify temporary numbers, which start with 'TN' or 2 digits
- company name, company UTR and registration number if they're a limited company
- nominated partner details, trading name and partnership UTR if they're a partnership

### Making deductions from payments:

Once a subcontractor has been verified, HMRC will confirm what rate of deduction should be applied to the labour element of the payment:

- if the subcontractor has gross payment status, no deductions need to be made from payments
- if the subcontractor has been registered with HMRC but has not applied for gross status, then deductions are made at 20%

- if you cannot verify the subcontractor, deductions must be made at 30%

Where deductions are to be made at either 20% or 30%, this should be applied to the labour element of the invoice only. Where the subcontractor has separated out the invoice between labour and materials costs, it is the contractors' responsibility to:

- Obtain evidence from the subcontractor for the direct cost of materials. This is because contractors must be prepared to produce evidence, capable of standing up to proper scrutiny, that any amount which it has treated as being payment for materials costs does indeed truly represent that costs.
- Where materials can not be backed up with evidence, the contractor must apply the appropriate rate of deduction to the full value of the invoice before making a payment.

**Please note failure to be able to verify the cost of materials can lead to penalties if investigated by HMRC.**

For existing contractors who have not previously verified the cost of materials when making payments to subcontractors, we suggest that you write to all of your subcontractors notifying them that you will not be able to take into consideration the cost of materials when making CIS deductions, unless the contractor is provided with suitable evidence of the cost of materials.

## CIS returns:

Contractors must tell HMRC each month about the payments they have made to subcontractors and this is done by producing a monthly CIS return. The CIS return should be submitted to HMRC through the HMRC CIS online service and in order to avoid penalties, this must be done by the 19th of every month. CIS returns include details such as:

- the total payments made to subcontractors (excluding any CIS deductions and VAT).
- the labour element of the payments.
- the total CIS deductions that have been made from the payments.

Where a contractor has deducted CIS tax from payments to subcontractors, this must be paid across to HMRC by no later than the 22nd of every month.

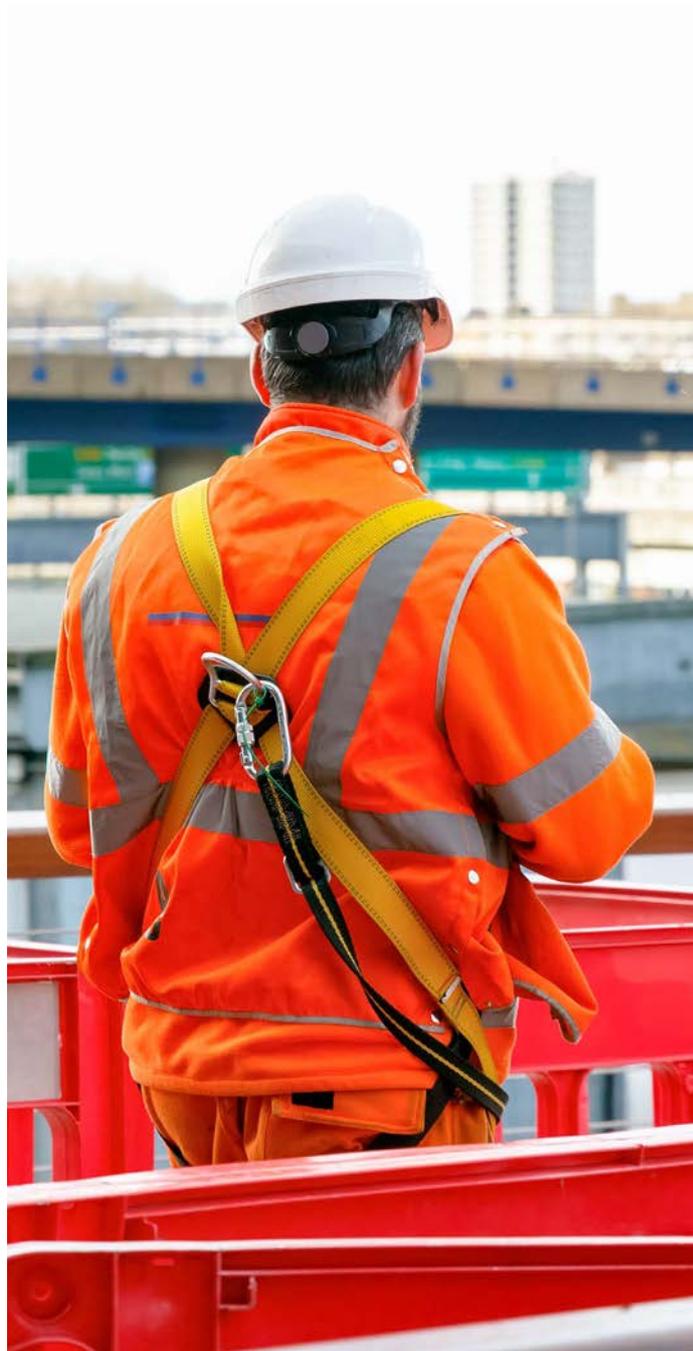
**Please note, failure to appropriately deduct payments from subcontractors and prepare accurate CIS returns can lead to significant penalties.**

## Subcontractor statements:

Contractors must give a written statement to every subcontractor they make a deduction from and this must be done within 14 days of the end of each tax month. The statement gives a breakdown of the payments and deductions that have been made.

**Please note HMRC are issuing penalties for contractors which are failing to provide statement certificates within the 14 day time frame.**

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# 'Careless' certificate highlights difficulties acquiring RCP status

Marlow Rowing Club was a not for profit entity looking to build a water sports hub for use by themselves, other local clubs and for the gym facility. Non-members as well as members would be welcome.

The club was aware of an on-going issue involving Longridge on Thames; a charity which had built a riverside complex. Longridge had issued a certificate to the main contractor stating that the building was to be used wholly for Relevant Charitable Purposes (RCP) and therefore the supply of the construction services by the main supplier could be zero-rated.

HMRC had ruled that the Longridge property was not RCP, and at the time Marlow Rowing Club was planning the water sports hub Longridge had won at both the First and Upper Tier Tribunals.

The Club took professional advice including that from Counsel. The advice was that if Longridge survived the

Court of Appeal (as HMRC had appealed), then there were strong grounds for Marlow Rowing Club to also issue an RCP certificate.

The Club duly issued the RCP certificate. Shortly after, Longridge lost at the Court of Appeal. Marlow Rowing Club withdrew the certificate but HMRC penalised them for issuing a false certificate. The Club appealed the penalty on the grounds that it was "fair and reasonable" to have issued it when it did and that they had taken advice on the matter. The Tribunal disagreed and said that the Club should have discussed the matter with HMRC before issuing the certificate, and then look to appeal any disagreement with HMRC on the matter and ask that this appeal was stayed behind the outcome of the Longridge case.

The case also indicates that the charity did not act as was understood by Counsel, so is likely to have failed anyway.

This case illustrates that there are very limited grounds for getting RCP status for a property (or part of a property). If you believe you have a project that involves RCP (or perhaps your customer is insisting that it does), please talk to the Property team for more guidance.

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