

Navigating VAT in the Construction Industry

A basic guide for SME's in Construction



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INTRODUCTION

This presentation is a basic guide on VAT in the construction industry.

This Guide sets out the basics however you should always seek independent advice.

The UK tax code is 10 million words and 21,000 pages long. Every case is different, some being basic and other highly technical, each case should be reviewed on its own merits.

Meet THE TEAM



Iain Campbell
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About us

Cogency are specialist construction accountants who's main aim to remove any finance and administration burden away from owner managers so they can do what they do best... work on the business.

We help other construction companies with the following:

- Set out a growth strategy
- Structure your business commercially and tax efficient
- Structure your personal income in a tax efficient manner
- Educate and act as a soundboard not just for tax and compliance issues but for other business issues that arise. Given the nature of your issues, these may not be issues you can easily discuss with your family and friends.
- We can provide our clients with more real time data, allowing them to understand how much profit they are making, providing insights to cash flow and getting them to understand estimated tax liabilities periodically rather than a last minute tax bill.
- Our clients are busy people running their business, they need to focus time and energy on what they do best, not to deal with their accounting, we tailor our services to solve our clients pain points.
- We have dedicated account managers that are constantly in communication with our clients, we're not a once-a-year accountant and we certainly don't pass clients around the office.
- We keep up to date with latest trends from legislation to technology.
- We understand its difficult running and building a business, sometimes business owners have 5 different roles, from operation to sales to cleaning. We aim to take at least one of them away and that's accounting/finance allowing you to focus on your business.

1 - What is VAT (Value Added Tax)?

For business owners in the United Kingdom, understanding the intricacies of Value Added Tax (VAT) is crucial. VAT is a consumption tax levied on the value added to goods and services. Whether you are a seasoned entrepreneur or just starting your business journey, navigating the VAT landscape is essential for compliance and financial management. In this article, we will explore key aspects of VAT in the UK and provide insights to help you effectively manage your business taxes.

2 - Who has to register for VAT?

You must register if:

- your total VAT taxable turnover for the last 12 months was over £90,000 (the VAT threshold)
- you expect your turnover to go over £90,000 in the next 30 days

You must also register (regardless of VAT taxable turnover) if all of the following are true:

- you're based outside the UK
- your business is based outside the UK
- you supply any goods or services to the UK (or expect to in the next 30 days)

Other key facts:

You can choose to register for VAT if your turnover is less than £90,000 ('voluntary registration').

You must pay HM Revenue and Customs (HMRC) any VAT you owe from the date they register you.

If everything you sell is exempt from VAT, you do not have to register for VAT.

You must register if, by the end of any month, your total VAT taxable turnover for the last 12 months was over £90,000.

You have to register within 30 days of the end of the month when you went over the threshold. Your effective date of registration is the first day of the second month after you go over the threshold.

Important Information!!!

You must register if you realise that your annual total VAT taxable turnover is going to go over the £90,000 threshold in the next 30 days.

You have to register by the end of that 30-day period. Your effective date of registration is the date you realised, not the date your turnover went over the threshold.

Vat registration isn't based on your accounting period, tax year, year end etc. Its calculated on a 12 month rolling basis, we have VAT registration trackers we can provide to help you understand your vat registration obligation and such timings.

Example 1

Between 10 July 2019 and 9 July 2020 your VAT taxable turnover is £100,000. That's the first time it has gone over the VAT threshold.

You must register by 30 August 2020. Your effective date of registration is 1 September 2020.

Example 2

On 1 May, you arrange a £100,000 contract to provide services.

You'll be paid at the end of May. You must register by 30 May. Your effective date of registration will be 1 May.

3 - How to calculate how much you owe or owed?

Businesses who are VAT registered will charge VAT (Output Tax) and also may pay VAT on their costs (Input Tax). The amount owed to HMRC or owed back from HMRC is the difference between the two.

For example John owns a construction company, his sales are £200k a year and charge VAT of £40k. John also pays VAT on some of his costs but not all of them. After reviewing the costs, we find that there is £20k of input tax to claim. Therefore John owes £20k in VAT.

4 - VAT Rates

VAT RATES	Application
20%	Most goods and services.
5%	Some goods and services, eg children's car seats and home energy.
0%	Zero-rated goods and services, eg most food and children's clothes.
Exempt	Some things are exempt, such as postage stamps, financial and property transactions.

5 - VAT Domestic Reverse Charge

The VAT domestic reverse charge must be used for most supplies of building and construction services. The charge applies to standard and reduced rate VAT services:

- for businesses who are registered for VAT in the UK
- reported within the Construction Industry Scheme

Domestic Reverse Charge Does Apply	Domestic Reverse Charge Doesn't Apply
<p>Constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services.</p>	<p>Drilling for, or extracting, oil or natural gas.</p>
<p>Constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours, pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence.</p>	<p>Extracting minerals (using underground or surface working) and tunnelling, boring, or construction of underground works, for this purpose.</p>
<p>Installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure.</p>	<p>Manufacturing building or engineering components or equipment, materials, plant or machinery, or delivering any of these to site.</p>
<p>Internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration.</p>	<p>Manufacturing components for heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems, or delivering any of these to site.</p>

Domestic Reverse Charge Does Apply	Domestic Reverse Charge Doesn't Apply
Painting or decorating the inside or the external surfaces of any building or structure.	the professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants
Services which form an integral part of, or are part of the preparation or completion of the services, 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.	making, installing and repairing art works such as sculptures, murals and other items that are purely artistic
	signwriting and erecting, installing and repairing signboards and advertisements
	installing seating, blinds and shutters
	installing security systems, including burglar alarms, closed circuit television and public address systems

6 - Reduced VAT for disable person.

You may not have to charge VAT on alterations you make to a disabled person's home, or certain equipment you supply for their personal use.

Who qualifies as 'disabled'?

To be **zero-rated** for VAT, the work you're doing needs to be for someone with a:

- physical or mental impairment that has a major long-term effect on their ability to do everyday activities
- condition that the medical profession treats as a chronic sickness (eg diabetes)
- terminal illness

Someone who's temporarily disabled or incapacitated, or elderly and frail but not disabled, does not qualify. However, you may be able to charge reduced-rate VAT at **5%** on mobility aids, heating and security work for people over 60.

Alterations

Work on a disabled person's home that can be zero-rated includes:

- building a ramp.
- widening (but not building) a doorway or passage.
- installing, extending or adapting a bathroom, washroom or lavatory to suit their condition.
- installing, repairing or maintaining a lift used to help them move between floors.
- preparation and restoration of the immediately surrounding décor.

Evidence of eligibility

You're responsible for making sure that your customer is eligible for zero-rate VAT, and you should be able to prove this from your records.

You can do this by getting your disabled customers (or a parent, guardian, doctor or another responsible person if they're not able) to sign a declaration containing information that shows they're eligible.

The VAT rate charge depends on what the goods and services are. You should always seek advice if your unsure.

7 - MTD (Making Tax Digital)

It is now mandatory for all VAT-registered businesses to comply with the MTD for VAT regime and it is no longer possible to submit VAT returns to HMRC via their web portal.

MTD does not require you to keep additional records for VAT, but to record them digitally. If you don't already, you'll need to start keeping digital records. This can be via a spreadsheet or bookkeeping software.

A spreadsheet can be used to calculate or summarise VAT transactions to arrive at the return information you need to send to HMRC. You will however need to file your VAT return through electronic software.



8 - VAT Invoicing Rules

A VAT invoice is the term for an invoice which contains some information required by the VAT rules. Most commercial invoices will already meet the requirements.

Only VAT-registered businesses can issue VAT invoices and if you're VAT-registered, you must issue a VAT invoice whenever you supply standard rate or reduced rate goods or services to another VAT-registered person.

The VAT invoices you issue form a very important part of your business records and you must keep a copy of every VAT invoice you issue.

Importance of VAT invoices

Similarly the VAT invoices you receive are the primary evidence for you to recover VAT you have incurred as input tax and you should make sure you keep them in a way that allows you to find them easily when asked.

VAT invoices are crucial to your business customers because the VAT invoice is the primary evidence that'll allow them to recover the VAT you've charged.

You must show the following details on any VAT invoices you issue:

- a sequential number based on one or more series which uniquely identifies the document.
- the time of the supply.
- the date of issue of the document (where different to the time of supply).
- the name, address and VAT registration number of the supplier.
- the name and address of the person to whom the goods or services are supplied.
- a description sufficient to identify the goods or services supplied.

Special rules apply to invoices issued subject to a reverse charge. You need to follow the rules for such supplies.

- for each description, the quantity of the goods or the extent of the services, and the rate of VAT and the amount payable, excluding VAT, expressed in any currency.
- the gross total amount payable, excluding VAT, expressed in any currency.
- the rate of any cash discount offered.
- the total amount of VAT chargeable, expressed in sterling.
- the unit price.
- the reason for any zero rate or exemption.

9 - Recordkeeping

The basic rule is that you must create and keep normal business records. VAT law requires you to keep all your business records. Our view of business records is wide and will include:

- annual accounts, including profit and loss accounts
- bank statements and paying-in slips
- cash books and other account books
- credit or debit notes you issue or receive
- documentation relating to dispatches and acquisitions of goods to or from the UK or EU member if you are registered in Northern Ireland or relating to dispatches and acquisitions made before 1 January 2020 if you are registered in Great Britain
- documents or certificates supporting special VAT treatment such as relief on supplies to visiting forces or zero rating by certificate
- import and export documents
- orders and delivery notes
- purchase and sales books

- purchase invoices and copy sales invoices
- records of daily takings such as till rolls
- relevant business correspondence
- VAT account (electronic account)

What a business record is will depend on the type of business you run. You'll always have to keep a VAT account and copies of invoices, but some of the other records may not be a normal record in your business. If that's the case you do not have to keep such a record just for VAT. But equally, some businesses will create additional business records and these must be kept and produced to HMRC when you're asked.

Generally, you must keep all your business records for VAT purposes for at least 6 years however at cogency we advise to keep records for at least 7 years to ensure 6 full years of records are held at any one time. Records that you use for other tax purposes may need to be kept for longer periods.

10 - Key Dates

VAT returns and payments are typically due 1 month and 7 days after the VAT period. Typically a VAT period is 3 months long.

Your VAT period tends to be in line with the date you register so if you register on the 1st April then your period would be April to June and you would have to until 7th August to file the return and pay any liability. Your next returns would then be July to September, October to December and January to March and so on.

As this is the case your VAT returns can be out of line with your year end. So if you have an April year end and your VAT return ends on March then your VAT returns are not inline. Its always best to line up your VAT with your year end so you can reconcile your VAT liability when completing your year end accounts.

Its quite simple to apply for a change in your VAT stagger with HMRC, they will either allow you to produce a small VAT return or a longer VAT return to change the stagger so your subsequent VAT returns are then inline.

11 - Penalties

Late submission penalty

For VAT accounting periods starting on or after 1 January 2023, late submission penalties apply if you submit your VAT Return late. This includes nil or repayment returns.

Late submission penalties work on a points-based system.

For each return you submit late, you'll receive a penalty point until you reach the penalty point threshold.

When you reach the threshold, you'll receive a £200 penalty. You'll also receive a further £200 penalty for each subsequent late submission while you're at the threshold.

Penalty points threshold for your accounting period

For VAT accounting periods starting on or after 1 January 2023, late submission penalties apply if you submit your VAT Return late. This includes nil or repayment returns.

Late submission penalties work on a points-based system. For each return you submit late, you'll receive a penalty point until you reach the penalty point threshold. When you reach the threshold, you'll receive a £200 penalty. You'll also receive a further £200 penalty for each subsequent late submission while you're at the threshold.

Accounting Period	Penalty points threshold
Annually	3
Quarterly	4
Monthly	5

Penalty example for a business making quarterly returns

A company submits their VAT Return quarterly. This means their penalty point threshold is 4.

They already have 3 penalty points because they submitted 3 previous returns late.

They submit their next return late and get a fourth penalty point. Because they've reached the penalty point threshold, they receive a £200 penalty.

The company submits their next return on time. They stay at threshold of 4 penalty points but do not get a £200 penalty.

The company submits their next return late. As they're still at the penalty point threshold of 4 points, they receive another £200 penalty.

Late payment penalty

From 1st January 2023 late payment penalties apply to late VAT payments. These payments can apply to any VAT not paid by the relevant due date. For late payment penalties, the sooner you pay the lower the penalty will be.

If you are struggling to pay then there are options, please see the struggling to pay section in this guide. You'll get a first late payment penalty if your payment is 16 or more days overdue. When your payment is 31 or more days overdue, your first late payment penalty increases, and you get a second late payment penalty.

	First late payment penalty	Second late payment penalty
Payment up to 15 days overdue	None.	None.
Payment between 16 and 30 days overdue	Calculated at 2% on the VAT you owe at day 15.	None.
Payment 31 days or more overdue	Calculated at: <ul style="list-style-type: none"> • 2% of what was outstanding at day 15. • plus 2% of what is still outstanding at day 30. 	Calculated at: <ul style="list-style-type: none"> • a daily rate of 4% per year on the outstanding balance. • charged everyday from day 31 until the outstanding balance is paid in full.

Example

A company is a VAT registered retailer that has submitted their June 2024 return by the deadline for their reporting period. But HMRC does not receive the £15,000 VAT they owe on time.

Payment is up to 15 days overdue

HMRC sends the company a late payment reminder letter asking them to pay in full to avoid penalties. They settle their VAT bill in full by the end of day 15 so they do not get a late payment penalty.

Payment is between 16 and 30 days overdue

The company makes full payment between day 16 and day 30 after the VAT is due. The first late payment penalty is calculated at 2% of the VAT that was outstanding at the end of the day 15. HMRC charges a first late payment penalty of 2% of £15,000 = £300

Payment is 31 days or more overdue

The company pays the VAT they owe 51 days after the date it is due.

HMRC charges a first late payment penalty of £600, calculated at:

- 2% of the amount outstanding at day 15 (2% of £15,000 = £300)
- 2% of the amount outstanding at day 30 (2% of £15,000 = £300)

HMRC also charges a second late payment penalty calculated daily at an annual rate equivalent to 4% on the outstanding amount of £15,000.

HMRC charges 4% from day 31 of the payment being overdue up to and including day 51 when the company pays in full.

This works out as 21 days ($£15,000 \times 4\% \times 21/365 \text{ days}$) = £34.50

The total penalty that the company is charged for paying 51 days late is £634.50 from the:

- first late payment penalty of £600
- second late payment penalty of £34.50

12 - How to pay VAT

Typically at Cogency we advise clients to pay their VAT two ways:

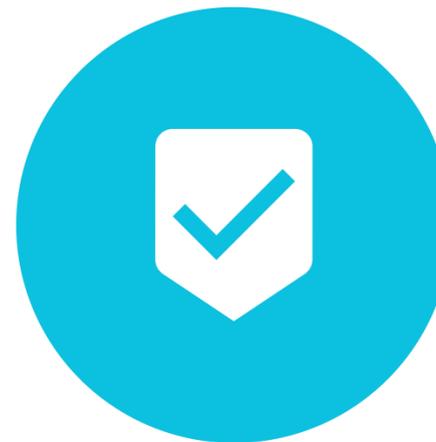
Payment Method	How to pay
Card payment	<p>If you wish to pay by card then you can follow this link https://www.gov.uk/pay-vat</p> <p>You will need your 9 digit VAT number, card details that you wish to pay with and the VAT amount to pay.</p>
Bank Transfer	<p>If you wish to pay by bank transfer then use the following details:</p> <ul style="list-style-type: none"> • Sort code - 08 32 00 • Account number - 11963155 • Account name - HMRC VAT • You should use your VAT number as the reference.

13 - Struggling to Pay VAT

If you cannot pay your tax bill in full, you may be able to set up a payment plan to pay it in instalments. This is called a 'Time to Pay' arrangement.

At Cogency we have helped numerous clients obtain a formal time to pay avoiding any penalties for late payment.

Make sure you always check what your options are before the payment due date to arrange in time otherwise we can't guarantee that you will not receive a penalty.



14 - VAT Schemes

There are various VAT schemes you maybe able to join depending on your taxable turnover and type of business. We haven't listed them all out below however we have listed those that are relevant to the construction industry. You may be able to use the cash accounting and annual accounting schemes if your annual turnover is £1.35m or less excluding VAT and you maybe able to use the Flat Rate Scheme if your annual turnover is £150,000 or less excluding VAT:

VAT Scheme	Description
Cash Accounting	<p>Pay VAT to HMRC when your customer pays you rather than when you invoice them. There can be a cashflow advantage especially in the construction industry if you have difficulty getting paid by your customers and/or if you give credit to your customers.</p> <p>Usually, the amount of VAT you pay HM Revenue and Customs (HMRC) is the difference between your sales invoices and purchase invoices. You have to report these figures and pay any money to HMRC even if the invoices have not been paid.</p> <p>With the Cash Accounting Scheme you:</p> <ul style="list-style-type: none"> • pay VAT on your sales when your customers pay you or • reclaim VAT on your purchases when you have paid your supplier

VAT Scheme	Description
<p>Annual Accounting Scheme</p>	<p>Usually, VAT- registered businesses submit their VAT Returns and payments to HM Revenue and Customs 4 times a year. With the Annual Accounting Scheme you: make advance VAT payments towards your VAT bill - based on your last return (or estimated if you're new to VAT) and submit 1 VAT Return a year.</p> <p>When you submit your VAT Return you either:</p> <ul style="list-style-type: none"> • make a final payment - the difference between your advance payments and actual VAT bill • apply for a refund - if you've overpaid your VAT bill <p>The scheme would not suit your business if you regularly reclaim VAT because you'll only be able to get 1 refund a year (when you submit the VAT Return).</p>
<p>Flat Rate Scheme</p>	<p>Flat rate Scheme lets you work out what you owe HMRC in VAT as a percentage of your gross turnover.</p> <p>The amount of VAT a business pays or claims back from HM Revenue and Customs (HMRC) is usually the difference between the VAT charged by the business to customers and the VAT the business pays on their own purchases.</p> <p>With the Flat Rate Scheme:</p> <ul style="list-style-type: none"> • you pay a fixed rate of VAT to HMRC • you keep the difference between what you charge your customers and pay to HMRC • you cannot reclaim the VAT on your purchases - except for certain capital assets over £2,000

15. Common VAT Misconceptions

- 01** *Misconception: VAT is always 20%*
Reality: While 20% is the current standard rate in the UK, different items may be subject to reduced rates (e.g. 5%) or be zero-rated. Some goods and services may also be exempt from VAT.
- 02** *Misconception: VAT is always reclaimable on business expenses*
Reality: Some expenses, especially those related to exempt or outside-the-scope activities, may not be eligible for full VAT reclaims.
- 03** *Misconception: VAT registration only applies to limited companies*
Reality: VAT registration isn't determined by business structure. If you supply goods or services to the UK and your turnover is to exceed £90k in 12 months then you may have to register.
- 04** *Misconception: VAT registration threshold applies to profit, not sales*
Reality: The VAT registration threshold is based on taxable turnover, not profit. Once a business's taxable turnover exceeds the threshold, it must register for VAT.
- 05** *Misconception: VAT registration is optional*
Reality: If a business's taxable turnover exceeds the VAT registration threshold, registration is mandatory. Voluntary registration is also possible, allowing businesses to reclaim VAT on expenses.
- 06** *Misconception: VAT Is Always a Cost to the Business*
Reality: VAT is a consumption tax ultimately borne by the end consumer. While businesses collect and remit VAT to tax authorities, they are not financially burdened by the tax itself.
- 07** *Misconception: VAT Is Uniform Across the EU*
Reality: Each EU member state has the authority to set its own VAT rates and rules. While there are common principles, actual rates can vary.
- 08** *Misconception: VAT Is Only Applicable to Goods*
Reality: VAT is also applicable to services and digital goods, making it a broad-based consumption tax.
- 09** *Misconception: VAT Is Irrelevant for Exported Goods and Services*
Reality: While exports are generally zero-rated for VAT, businesses still need to adhere to specific VAT rules and documentation requirements for cross-border transactions.
- 10** *Misconception: VAT Returns Are Simple*
Reality: VAT returns involve detailed calculations, proper record-keeping, and compliance with VAT regulations. Errors or omissions can lead to penalties.

THANK YOU

Disclaimer

This guide shall not be construed as a formal opinion by Cogency on any aspect covered herein. Businesses and individuals dealing with VAT should seek professional advice and stay informed about VAT regulations to ensure compliance and avoid costly mistakes. Every case should be taken on its own merits.