THE IMPLICATIONS OF BREXIT FOR THE CONSTRUCTION SECTOR

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A NOTE FROM THE AUTHOR

By definition, construction is forward looking. As a creator, innovator and employer across the UK, the industry's role presents many opportunities to explore in the years ahead.

There are also challenges for construction businesses to navigate. Brexit and its effects on trade, immigration and law; a complex and changing tax landscape, including the Construction Services Domestic Reverse Charge from March 2021; and not forgetting the coronavirus pandemic's continuing economic impact.

In this report, we and other experts will share insights into these challenges and opportunities, and how the sector can meet them in the way it knows best: constructively.

IN THIS REPORT

WHAT DOES BREXIT MEAN FOR THE CONSTRUCTION SECTOR?

Construction is one of the largest and most important sectors of the UK economy. A sector that generates around 6% of GDP, and employs 7% of the entire workforce, was always likely to experience knock-on effects from the economic consequences of the UK leaving the EU. So, what should we expect to see?

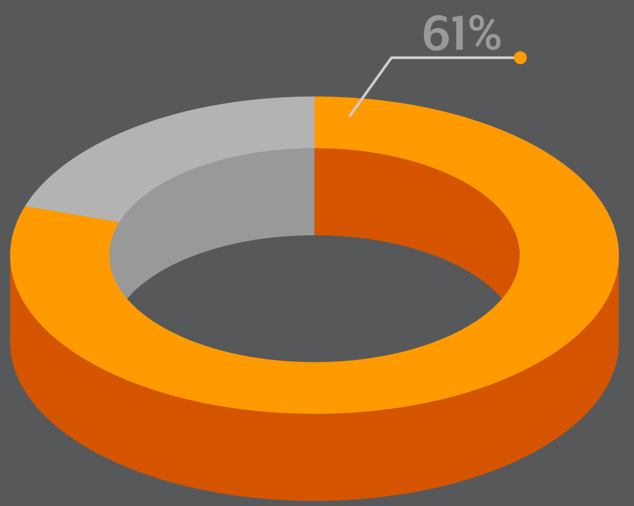
The UK-EU Trade and Cooperation Agreement announced on 24 December 2020 answered one of the most pressing questions: imported building materials will not attract tariffs. But while the Brexit trade deal was welcomed with relief by the industry, there are a number of important issues that will need close attention in the coming months.

Almost **2 MILLION**
people are employed in the construction industry

MATERIALS

The EU is the sector's primary source of imports, accounting for over 60% of total building component and material imports in 2015 . While the trade agreement ensures that imports can continue without tariffs, there is real concern that the additional paperwork required by importers and exporters could cause significant delays in the supply chain – anecdotally, if it takes just two minutes longer for every vehicle to cross the Channel, the result will be 10 miles of queues and a 140 hour delay for lorries.

The Builders Merchants Federation has also expressed concern about the capacity of UK container ports after increased demand for some goods, such as Scandinavian timber, and coronavirus-related issues resulted in delays.



Accounting for 61% of total building component and material imports in 2015

PEOPLE

Construction is a labour-intensive business. In recent years, the pressures of demographic change have contributed to a growing skills crisis. In the year of the Brexit referendum, only 10% of the UK's construction workforce were under 25 and almost a third were over 50.

The sector relies heavily on overseas workers for both skilled and manual roles. It is estimated that up to 10% of the sector's workforce are EU nationals, but this proportion is in decline. The number of EU workers operating on construction sites in London has fallen sharply – from 115,000 to 53,000 – between 2018 and 2020.

The rules for employing EU nationals will change, but not until 1 July 2021. From that date, construction companies employing EU nationals will be required to check every applicant's right to work in the UK.

EU workers already employed in the UK at the end of 2020 will need to apply to remain under the government's EU Settlement Scheme, if they haven't done so already. From July 2021, their employer will need to ask for proof of their settled or pre-settled status. The new points-based immigration system for non-EU citizens and EU citizens who were not working in the UK before 31 December 2020 came into effect at the beginning of the year. Our article on UK immigration post-Brexit, later in this report, has more details.

LEGISLATION

One of the most significant issues for construction companies post-Brexit is VAT on imports and exports. This has added even more complexity to an already challenging area.

The new VAT regime means, for example, that importers and exporters will need an Economic Operators Registration and Identification (EORI) number for both customers and VAT documentation (and sometimes more than one, depending on where they import and export to).

The sector must also cope with the complexity of the new Construction Services Domestic Reverse Charge (CSDRC) rules for VAT, which came into force on 1 March 2021. You can read more about the CSDRC later in this report.

Nor is VAT the only legislative change affecting the construction sector. For example, importers and exporters of timber between the EU and UK may also need to prove that the timber has been legally harvested.

The trade deal contains little detail on regulation and is silent on whether the UK will develop its own standards for building products and materials, or continue to follow EU regulation. Construction companies will need to keep up to date with developments over the coming months and years.

If it takes just two minutes longer for every vehicle to cross the Channel, the result will be 10 miles of queues and a 140 hour delay for lorries.

HOW TO MITIGATE BREXIT RISK

Here are eight practical steps that construction businesses can take to prepare themselves for the imminent changes.

1. ASSESS RISK IN YOUR SUPPLY CHAIN

It has never been more important to have a full and clear picture of the entire supply chain, as Brexit-associated risk can extend well beyond your immediate suppliers.

/ Who are your suppliers' suppliers?
/ Could they be affected?
/ Are any subcontractors exposed to possible delays at the border?

2. CARRY OUT A CONTRACT AUDIT

Every separate contract should be reviewed for Brexit implications. This will identify potential problems and prioritise a discussion of those most susceptible to risk (in terms of overruns, cost and profitability).

In a business where timings are notoriously tight, any delays along the supply chain could cause further problems.

/ Who is liable in the event of non-delivery of goods or services? Does the contract stipulate fault?
/ Does it include specific Brexit language?
/ Can timings be renegotiated?
/ Could global tariff charges or foreign exchange rate fluctuations affect profitability of a contract?
/ Is there any scope to pass on costs to a counterparty?
/ What does Brexit mean for the profit margin of each contract?

Risk-assess your entire supply chain

Carry out a contract audit

Keep a close eye on cash

Review pricing models & business plan

Update or upgrade your software

3. KEEP A CLOSE EYE ON CASH

Solid management accounting and robust cashflow forecasting, which have always been important, take on a new urgency at a time when any hold-up in payments along the supply chain could cause difficulties.

Regular cashflow forecasting and robust scenario planning will give forewarning of trouble ahead. The options for accessing cash (or releasing cash from the business or working capital) should also be explored.

Bear in mind that if cash has been freed up in the short term by taking advantage of COVID-19 support schemes to delay VAT and CIS payments, this will soon come to an end – and the recent restoration of HMRC's preferential creditor status is a good indication that non-payment will not be tolerated.

4. REVIEW PRICING MODELS & THE BUSINESS PLAN

It seems inevitable that Brexit will cause additional cost in some areas, in the short term at least, such as procurement costs linked to a weaker pound, administration costs, or extra storage costs if companies need to stockpile materials.

/ Have all pricing implications been considered?
/ And are extra costs factored into pricing?

5. UPDATE OR UPGRADE YOUR SOFTWARE

Good accounting and project management software will help to get the business through the many changes brought in by Brexit. If existing packages are not up to scratch, it is time for an upgrade.

Make sure that all software is regularly updated as requirements may change and improvement and adjustments are constantly being introduced.

MITIGATING BREXIT RISK

6. REVIEW YOUR INSURANCE

The potential for overrunning contracts and projects has increased, so this is the time to check whether you are covered for any Brexit-related delays that are beyond your control.

There may be very little wiggle room in current agreements, so it is vital to review insurance contracts for any Brexit-related clauses and assess whether all risks are covered – it is becoming apparent that 'force majeure' contract terms may not cover Brexit-related situations.

7. PAY ATTENTION TO WORKFORCE ISSUES

It is likely that labour and skills shortages will be exacerbated by Brexit, at least for the moment. The planned salary cap built into the new points-based immigration system for non-EU migrant workers may restrict supply still further. It is never too early to explore any alternative sources of labour as competition is likely to be intense.

The additional admin around EU employees will also need to be carefully managed, with employers becoming responsible for checking the status of EU workers and their right to work in the UK from mid-2021. This includes part-time as well as full-time staff, regardless of their length of service; work experience students; and temporary workers. Employers are not responsible for subcontractors recruited by a third party or anyone employed directly by an employment agency.

8. FOLLOW DEVELOPMENTS

The trade deal was only the beginning of the new UK-EU relationship. There is much more detail to come, not least the question of quality standards. It is vital to keep up with developments to allow yourself maximum time to plan.

THE OUTLOOK IS BRIGHT

There's no doubt that the changes ushered in by Brexit are considerable. Adapting will take time and work. But despite any short-term disruption, the construction sector has more reason than most to remain optimistic.

The sector has fared well during the pandemic, with most sites remaining open and operating, thanks to teams who already understood the importance of health & safety procedures. Demand continues to be high: the government has already announced plans for a £1.3bn investment fund for housing and infrastructure projects as part of the UK's economic recovery. The property and construction sector is valued, viable and has a bright future ahead.

SUPPLY CHAINS AND RESILIENCE

Stephen Hand, Managing Director, Sales, Invoice Finance & ABL, SME & Mid Corporate at Lloyds Banking Group

The past year has brought unprecedented challenges for businesses. Many have had to take additional measures to control COVID-19's impact on their cashflow. Beyond this, Brexit adds potential complexity for those who import and export.

It's therefore no surprise that this rapidly changing, uncertain environment has brought to the fore the importance of supply chains, working capital and cashflow forecasting, and the need for sustainability in its widest sense. It has also revealed a longer-term liquidity need as businesses continue to protect funding taken under government support schemes.

Despite Brexit, the EU continues to be a key trading partner and ally. The UK currently has a surplus in services trade with the EU, but this is dwarfed by its deficit in goods trade where the value of imports from the EU far exceeds exports into the EU.

Our Business Barometer research reveals that 6 in 10 firms have experienced supply chain disruption since the start of the pandemic, with stock availability an issue for nearly 4 in 10 firms. Taking effective steps now will build resilience to future shocks and create a more sustainable supply chain. While there is no silver bullet solution, there are incremental changes that can reduce risk in any company's supply chain.

The design of any solution must reflect the impact on costs and the consumption of working capital as well as the benefits. These include supply chain visibility; diversification; alternative suppliers closer to home; Addressing inventory; forecasting demand.

Understanding the working capital cycle and effectively managing cashflow to pre-empt any working capital concerns will be key. For many businesses this will mean a clear understanding of suppliers' and customers' financial health and reinforcing good business practice: bolstering collections and credit management and setting credit limits.

As we move through 2021, lots of businesses will see their working capital profile change. We have seen a lot of companies embracing short-term methods to boost cashflow, like delaying payments. However, these aren't sustainable and will add risk to your supply chain. Understanding these changes and starting to adapt your business around that new profile is key.

LLOYDS BANKING GROUP

An opportunity to build back better

The review and redesign of supply chains provides wider opportunities. Incorporating environmental, social & governance (ESG) principles can help ensure a more sustainable future, as innovation moves to meet current challenges.

Environmental: as businesses reimagine their business model, they can accelerate the transition to a low-carbon economy. This will reduce climate risk, improve energy efficiency and offer strategic advantages.

Social: changes made at the top of organisations will impact business models and corporate culture. By supporting the most vulnerable in their recovery, including smaller suppliers, businesses will be contributing to Britain's financial resilience and helping to build a more inclusive society.

Governance: for companies to "build back better", they must have a strong corporate governance that is not only visible and environmentally sustainable, but also ethical.

Although many firms have been put to the test in the past twelve months, the success of their creative and agile approaches gives reasons for optimism. We're confident that the construction sector and others will continue to show a high level of resilience and adaptability.

Find out more on the Lloyds Bank Brexit Insights page or contact Lloyds here.

UK IMMIGRATION POST-BREXIT

Sharmila Mehta,
Partner at
Keystone Law

At 11pm on 31 December 2020, the UK's membership of the EU ended and with it came the end of UK/EEA free movement – the legal right of all EEA citizens to travel freely into the UK to live and work and for UK nationals to do the same in the EU.

What happens to those already living here?

The news isn't all bad. For those who were already resident in the UK on 31 December 2020 and can prove that they were living/working here, an application to the Home Office for approval under the European Union Settlement Scheme ("EUSS") is all that is required. Some 3 million people had already successfully applied by the end of last year.

The scheme lasts until 30 June 2021, after which those EEA nationals who haven't applied may be deemed not to have the legal status to remain here. Approval takes the form of either pre-settled or settled status. Both give EEA nationals the opportunity for UK citizenship in time.

What if you want to hire an EU national?

For those who have been granted approval under the EUSS, their right to live and work in the UK is protected and employers can, if they so wish, carry out a simple check via the Home Office website before recruiting these individuals.

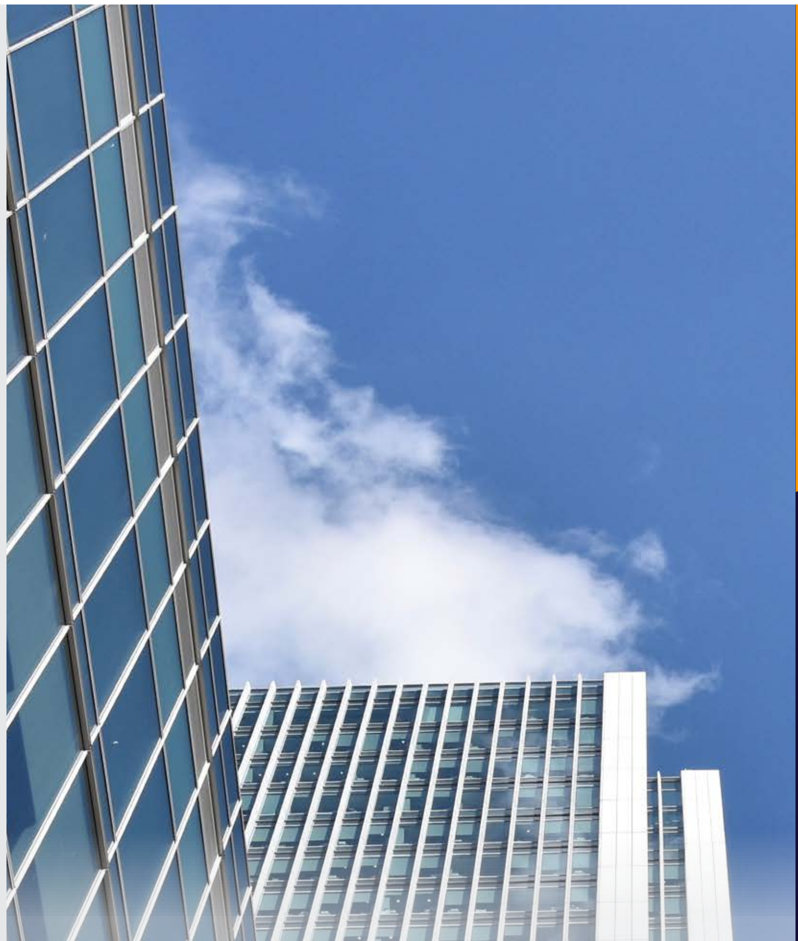
If, however, you're looking to hire an EEA national who was not here before 31 December 2020 or someone from outside the EU, the process can be slightly longer, with all employers required to possess a Home Office sponsor licence under which they can assign a "work permit" known as a certificate of sponsorship to the selected candidate. That individual will use their certificate to apply for a UK visa, coming in the category of Skilled Worker. It's a points system, awarded for qualifications, salary, skills and English language ability.

The new Skilled Worker scheme is designed to attract those with at least A-level qualifications or the equivalent, for jobs requiring that level of understanding or knowledge. This means that those workers who have traditionally come to the UK to work in construction as bricklayers, carpenters, plasterers won't qualify for sponsorship. This could pose a growing issue for the UK's construction industry.

However, potential employers should not be put off – the thresholds have been reduced and other than low skilled workers, most could qualify for UK entry. Architects, planning and civil engineers, and welding trades (in certain circumstances) all appear on the Skilled Worker Shortage Occupation List.

Holding a licence carries with it certain responsibilities and duties, which sponsors are required to comply with. It's about co-operating with the Home Office, being accountable and using your licence carefully. If done correctly, hiring the best person for the job, from anywhere in the world is possibly easier than it's ever been.

KEYSTONE LAW



Recommendations for employers

Plan hiring in advance

– and budget accordingly, to allow for Home Office application fees and visa fees. Remember it's the same process for hiring from the EU or from anywhere else in the world.

Obtain a sponsor licence.

Nominate an internal "immigration champion"

– someone willing to take responsibility for the company's international hiring.

Ensure robust HR processes

– such as: record keeping; knowing how and when to carry out Right to Work checks.

Who is affected?

Those from the following countries no longer have the right of free movement into the UK:

AUSTRIA	LATVIA
BELGIUM	LIECHTENSTEIN
BULGARIA	LITHUANIA
CROATIA	LUXEMBOURG
CYPRUS	MALTA
CZECH REPUBLIC	NETHERLANDS
DENMARK	NORWAY
ESTONIA	POLAND
FINLAND	PORTUGAL
FRANCE	ROMANIA
GERMANY	SLOVAKIA
GREECE	SLOVENIA
HUNGARY	SPAIN
ICELAND	SWEDEN
ITALY	SWITZERLAND

If you have any questions please contact **Sharmila Mehta** on **sharmila.mehta@keystonelaw.com** or call **+44 (0)20 3319 3700.**

THE CONSTRUCTION SERVICES DOMESTIC REVERSE CHARGE IS HERE

With all eyes on the pandemic and Brexit, it was easy to miss a key date in the VAT calendar – the introduction of the long-delayed Construction Services Domestic Reverse Charge (CSDRC) on 1 March 2021.

Simon Levine,

Senior VAT Adviser at BKL

The scheme was originally due to come into effect in October 2019 but the sector was deemed to be unprepared, and was delayed again due to COVID-19 – but this time it is going ahead and HMRC expects contractors and subcontractors to be aware.

With so much else going on, it has been tempting to kick the can down the road and assume the CSDRC could be dealt with at the last minute, or that HMRC would allow some wiggle room. But that would be a risky approach. After conducting an extensive publicity campaign and delaying implementation for more than a year, HMRC is primed to enforce the CSDRC and is unlikely to accept ignorance as an excuse. As we emerge from the pandemic and VAT inspections inevitably resume, we expect the construction sector to be a focus area as a result of the changes.

Let's remind ourselves of the details of the scheme:

/ The CSDRC applies to the same services as the Construction Industry Scheme (CIS) – i.e. construction, alteration or repair of buildings, some electrical and plumbing work, site clearance and so on

/ As of 1 March 2021, anyone applying these CIS services to a VAT and CIS registered customer is no longer required to account for VAT

/ Instead, the customer accounts for the VAT as if they had made the supply to themselves (and recover the same VAT as input tax, if appropriate). These self-supplies do not count towards the VAT registration limit

/ The scheme does not apply to zero-rated supplies or to supplies made by someone who is not VAT registered

/ 'End user' customers or intermediary customers are exempt, but they must inform their subcontractors in writing of their status

It may be tempting for some hard-pressed companies, rather than get to grips with the details, to continue to charge 20% VAT as before on the basis that it is better to charge too much than too little. Ironically, this is more likely to bring you to HMRC's attention – and if you are paying a supplier VAT when you shouldn't be, HMRC may well refuse to refund you.

If you weren't able to prepare yourself fully before 1 March, here's what to do:

/ Familiarise yourself with the rules. We have summarised the change here; the government guidance can be found here

/ Contact all contractors and explain that as of 1 March, you are no longer paying them VAT. Be clear that this is non-negotiable

/ Get written confirmation from contractors of their status under the regime, whether they qualify as end users or as contractors

/ For all contractors falling under the scheme, you will need to collect their VAT number and CIS details (and check that both are valid) so you can apply the reverse charge

/ Make sure your accounting software is updated and get advice if you need it

JOIN US:

LISTEN TO OUR EXPERTS DISCUSS THE TOPICS IN THIS REPORT IN FURTHER DETAIL

11 MAY AT 1PM

REGISTER HERE

Our experts will discuss:

- Supply chain challenges
- New VAT rules
- Challenges for EU workers
- The need for sustainability
- Building back better

The panellists:

Myfanwy Neville
Property and Construction Partner at BKL

Simon Eaton
Construction Partner at BKL

Richie Coulson
Area Director at Lloyds Banking Group

Sharmila Mehta
Partner at Keystone Law

MEET OUR CONSTRUCTION TEAM

Our team can advise on all construction industry issues such as the construction industry scheme, cashflow management and special purpose companies to minimise tax leakage.

We also have great experience in dealing with employment status issues and other tax investigation areas within the construction industry.

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