HOW DOES 'Reverse Charge VAT' work?
Creating a Xero invoice correctly as a Sub-Contractor...

simply accounts & xero

What is Domestic Reverse Charge VAT (DRC)?

Normally - when you send an invoice, you add VAT and collect that amount from your customer. Later, you pay the VAT to HMRC on your quarterly VAT return.

Under DRC - you do not collect any VAT from the contractor who has engaged you. Instead, you receive that amount in relief on your own VAT bill, while the contractor cannot claim VAT relief because no VAT has been paid in the transaction.

DRC is a mechanism HMRC uses to prevent VAT from needlessly moving back and forth between companies in the construction industry.

Even if you don't collect VAT under DRC, **you must still include** a special note on your invoice stating the reverse charge applies.

Domestic Reverse Charge VAT (DRC) can be tricky, as its application depends on the invoice details.

Different rules apply depending on if your invoice is for materials **or** labour **on their own**, or if your invoice is a materials / labour **mix**

Box 1 **To Begin:** Set amounts as **Tax Inclusive** in **Box 1**. **Then Consider:** Is your invoice **'mixed'** or standalone **materials or labour?**

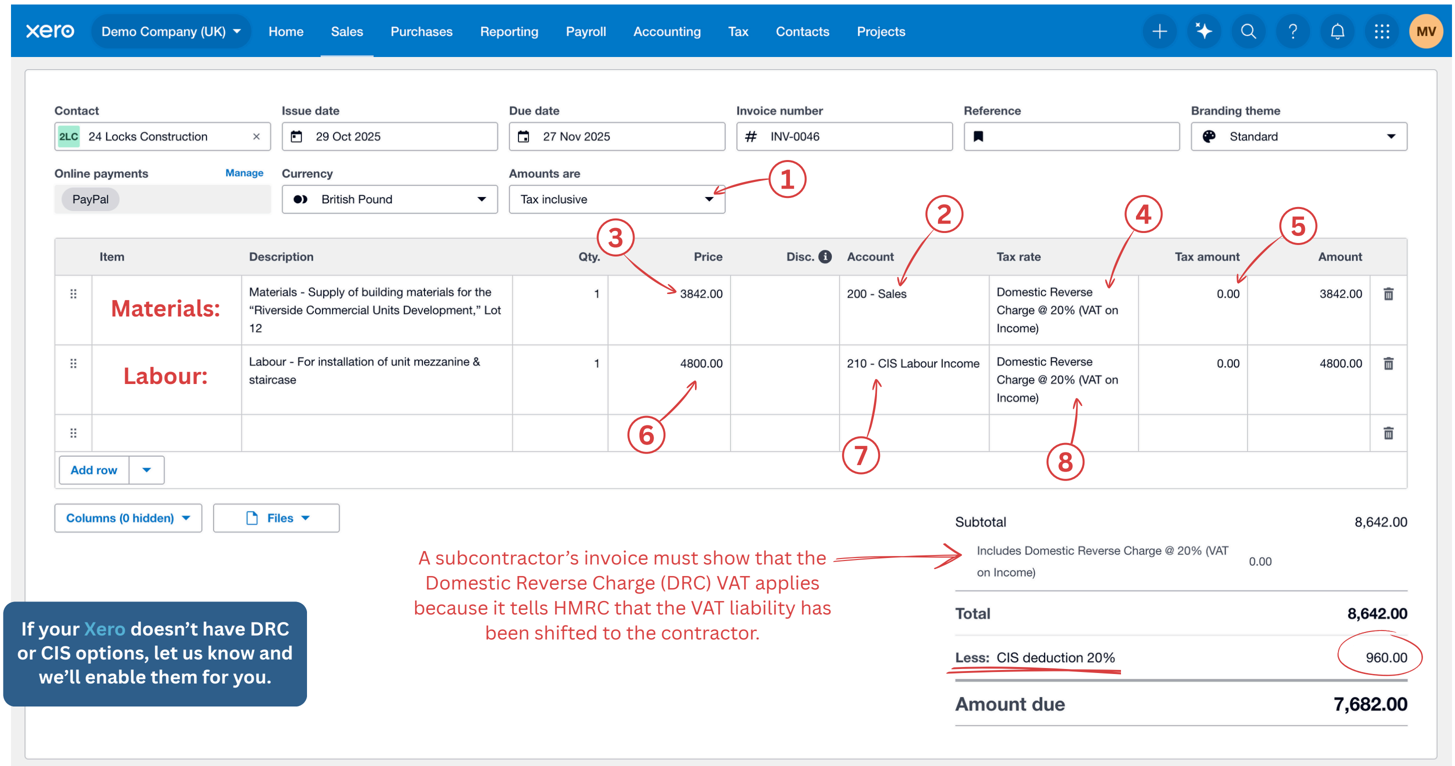
CIS for materials — Box 2

CIS never applies to materials - Even if your invoice is for materials on their own, **or** for materials as part of a mixed invoice.

Always **use your regular sales account** in box 2 for a 'materials' item.

DRC VAT for materials — Box 3 & 4

- **On an invoice containing only materials - DRC does not apply on the materials.** Enter the price of the materials including VAT into box 3 & select the regular tax rate in box 4 - likely '20% (VAT on Income)'.
- **Mixed invoice with materials and labour - DRC does apply on the materials.** Enter the price excluding VAT into box 3 and select the 'Domestic Reverse Charge @ 20% rate. The tax amount should show as zero in box 5.



xero | Demo Company (UK) | Home | Sales | Purchases | Reporting | Payroll | Accounting | Tax | Contacts | Projects

Contact	Issue date	Due date	Invoice number	Reference	Branding theme
24 Locks Construction	29 Oct 2025	27 Nov 2025	INV-0046		Standard

Online payments: PayPal (Manage) — Currency: British Pound — Amounts are: Tax inclusive (1)

Item	Description	Qty.	Price	Disc.	Account	Tax rate	Tax amount	Amount
Materials:	Materials - Supply of building materials for the "Riverside Commercial Units Development," Lot 12	1	3842.00 (3)		200 - Sales (2)	Domestic Reverse Charge @ 20% (VAT on Income) (4)	0.00 (5)	3842.00
Labour:	Labour - For installation of unit mezzanine & staircase	1	4800.00 (6)		210 - CIS Labour Income (7)	Domestic Reverse Charge @ 20% (VAT on Income) (8)	0.00	4800.00

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Subtotal	8,642.00
Includes Domestic Reverse Charge @ 20% (VAT on Income)	0.00
Total	**8,642.00**
Less: CIS deduction 20%	960.00
Amount due	**7,682.00**

A subcontractor's invoice must show that the Domestic Reverse Charge (DRC) VAT applies because it tells HMRC that the VAT liability has been shifted to the contractor.

If your Xero doesn't have DRC or CIS options, let us know and we'll enable them for you.

CIS VAT for labour — Box 7

CIS always applies to labour - Even if your invoice is for labour on its own, **or** for labour as part of a mixed invoice.

Always **use your CIS 'Labour Income' account** in box 7 for any 'labour' items.

DRC VAT for labour — Box 6 & 8

On either an invoice with only labour, or a mixed invoice - DRC always applies on the labour. - Enter the price of the labour excluding VAT into box 6 & select the 'Domestic Reverse Charge @ 20%' rate in box 8. The tax amount should show as zero.

Domestic Reverse Charge VAT
Working Invoice Examples

When invoicing for only materials:

- Domestic Reverse Charge VAT (DRC) **does not** apply **on materials** when the invoice contains **only materials**. Enter the price **including** VAT and select standard 20% vat rate for the Tax rate *(unless working on a barn project where 5% VAT rates apply)*.
- **CIS never applies to materials** - use your usual sales account.

	Item	Description	Qty.	Price	Disc.	Account	Tax rate	Tax amount	Amount
⠿		Materials for project	1	1200.00		200 - Sales	20% (VAT on Income)	200.00	1200.00
⠿									

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Subtotal		1,200.00
Includes 20% (VAT on Income)	200.00	
Total		**1,200.00**

When invoicing for only labour:

- Domestic Reverse Charge VAT (DRC) **does** apply **on labour** when the invoice contains **only labour**. Enter the price **excluding** VAT and select 'Domestic Reverse Charge @ 20%' Tax rate *(unless working on a barn project where a DRC 5% VAT rate applies)*.
- **CIS always applies to labour** - select the 'CIS Labour income' account

	Item	Description	Qty.	Price	Disc.	Account	Tax rate	Tax amount	Amount
⠿		Labour for project	1	1000.00		210 - CIS Labour Income	Domestic Reverse Charge @ 20% (VAT on Income)	0.00	1000.00
⠿									

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Subtotal		1,000.00
Includes Domestic Reverse Charge @ 20% (VAT on Income)	0.00	
Total		**1,000.00**
Less: CIS deduction 20%		200.00
Amount due		**800.00**

When building a mixed invoice for materials & labour:

Labour

- Domestic Reverse Charge VAT (DRC) **does** apply **on materials** on a mixed invoice. Enter the price **excluding** VAT and select 'Domestic Reverse Charge @ 20%' Tax rate *(unless working on a barn project where a DRC 5% VAT rate applies)*.
- **CIS never applies to labour** - use your usual sales account.

Materials

- Domestic Reverse Charge VAT (DRC) **does** apply **on labour** on a mixed invoice. Enter the price **excluding** VAT and select 'Domestic Reverse Charge @ 20%' Tax rate *(unless working on a barn project where a DRC 5% VAT rate applies)*.
- **CIS always applies to labour** - select the 'CIS Labour income' account

	Item	Description	Qty.	Price	Disc.	Account	Tax rate	Tax amount	Amount
⠿		Materials for project	1	1000.00		200 - Sales	Domestic Reverse Charge @ 20% (VAT on Income)	0.00	1000.00
⠿		Labour for project	1	1000.00		210 - CIS Labour Income	Domestic Reverse Charge @ 20% (VAT on Income)	0.00	1000.00
⠿									

Add row | Columns (0 hidden) | Files

Subtotal		2,000.00
Includes Domestic Reverse Charge @ 20% (VAT on Income)	0.00	
Total		**2,000.00**
Less: CIS deduction 20%		200.00
Amount due		**1,800.00**