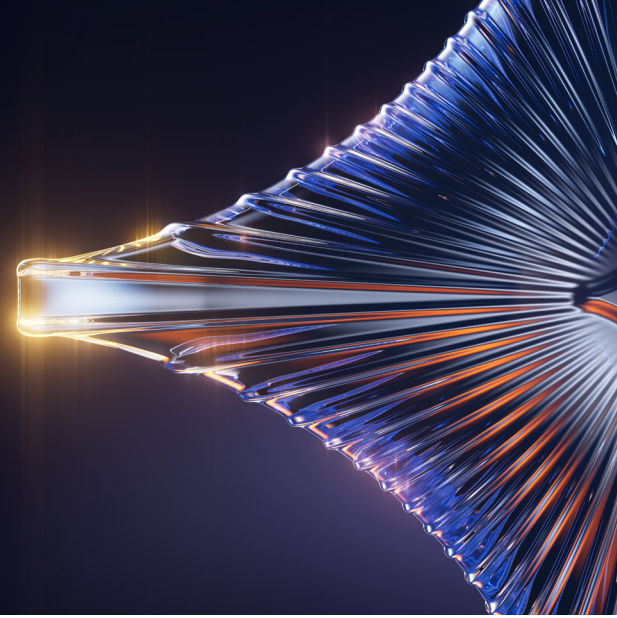


Construction Industry Scheme Challenges - Are you prepared?



The construction industry is traditionally regarded as having serious compliance issues. The changes introduced from 6 April 2024 suggest that HMRC remain focused in their compliance approach regarding the construction industry arena.

The Autumn Budget provided further proof that the Government were serious about tackling non-compliance by pledging additional resources for HMRC to recruit 5,000 compliance officers. We are also aware of HMRC sending out 'nudge letters' pointing out the risks of failing to operate CIS correctly.

The onus is on contractors to operate the CIS correctly, yet errors are commonplace. They can prove costly, especially if a subcontractor does not have gross payment status ('GPS') (i.e. no CIS tax deduction), since the contractor is liable for the additional tax due, including any interest and penalties that may be levied by HMRC.

With this in mind, we thought it would be beneficial to provide a brief overview of CIS, why it was introduced, how it has evolved over the years, recent changes and common mistakes contractors make when operating or not operating CIS.

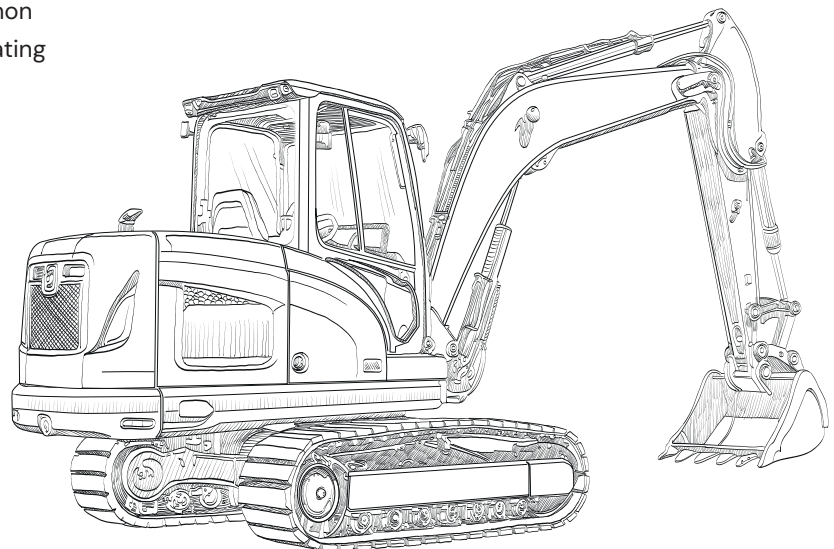
Background

Historically, self-employed workers were paid gross/cash in hand and it was left up to the worker to register with HMRC. False names were routinely given to contractors requiring a signature for the cash being paid out.

The CIS was introduced in 1971 to tackle this compliance problem and has undergone various changes with the current scheme being introduced in 2007.

This brought a change from a certificate-based scheme to:

- ◆ A requirement for contractors to verify subcontractors with HMRC either by telephone or, later, online
- ◆ The strengthening of the requirement for contractors to show that employment status had been considered prior to operating CIS; and
- ◆ The introduction of three classes of subcontractor; those with GPS, verified (20% deduction) and unverified (30% deduction) subcontractors.



There have been some further strengthening of the CIS rules applicable from 6 April 2021 and 6 April 2024, which we explain further below.

Common mistakes made when operating CIS

1. The Scope of CIS

Only construction operations fall under CIS and although it is easy to identify these in most cases, there are exceptions such as professional services (surveyors and architects), carpet fitting and delivering materials. To illustrate the point further, the fitting of carpets, linoleum, vinyl sheeting and other forms of floor covering is not considered a construction operation when carried out in isolation, that is, when done in a situation that does not also involve construction work.

Broadly, the fitting of all forms of floor covering included in the specification of a building undergoing construction, alteration or repair is caught by CIS, the exception is carpeting. However, carpet fitting can fall within CIS if it is part of a mixed contract, for example, the subcontractor is required to fit laminate flooring and fit carpeting under a single contract.

The starting point when reviewing if the work being carried out falls within CIS is to look at the contract for the work commissioned and not the payment in the first instance. A mixed contract is a contract that includes some work that falls within CIS and some that does not. In this instance, all payments made under that contract are brought within CIS.

2. Failing to register as a contractor or subcontractor

If a contractor fails to register with HMRC, they could face a £3,000 fine for not keeping CIS records, and a £100 per month penalty per missed return (returns are due monthly – the penalty becomes £300 or 5% of the CIS deductions on the return, whichever is higher if it is 6 months or more late). With regards to potential penalty for a subcontractor not registering under CIS, the immediate consequence is a higher tax deduction rate of 30% (rather than 20%). Furthermore, even if the subcontractor fails to register for CIS, tax returns would still need to be completed. Failure to submit tax returns can lead to fines and estimated tax bills.

3. Has the worker's employment status being considered?

This is not a matter of choice! It is important that the contractor is satisfied that a subcontractor is genuinely self-employed and that the contract and working arrangements support this to withstand any HMRC challenge. An error with the employment status of the worker means that the contractor will be held responsible

for the underpaid PAYE tax and national insurance contributions, as well as interest and penalties that may arise. Furthermore, there is also a potential £3,000 penalty if incorrect employment status declaration has been made for a subcontractor on the contractor's monthly CIS return.

4. Has the sub-contractor been verified?

To establish the correct rate of tax deduction, contractors need to verify a subcontractor with HMRC prior to making payment. If the subcontractor cannot be verified, then deduction at the higher rate of 30% should be applied.

5. Not submitting a return

Each month, the contractor must complete a return which details: all subcontractors used, all payments made, a declaration that the employment status of the subcontractor has been considered, and a declaration that all subcontractors have been verified.

We do come across some businesses who think that subcontractors who hold gross payment status do not need to be included on the monthly return because no CIS tax has been deducted – this is not correct. All payments made to subcontractors that fall within the scope of CIS must be recorded on the relevant monthly CIS return regardless of the amount of CIS tax deducted

6. Are the materials costs allowable?

Contractors are responsible for checking that the direct cost of materials claimed by a subcontractor is genuine and reasonable and has been directly incurred by the subcontractor before allowing the cost to be excluded from the amount on which CIS deductions are calculated. The wording in the legislation was changed in April 2021 so material costs are only allowable if they are a direct cost to the subcontractor for materials in relation to that particular contract. This rule was introduced to circumvent cost of deductions being incorrectly claimed in cases where there is a chain of subcontractors.

HMRC expect contractors to have systems and processes in place to check the cost of materials claimed. In our experience, material costs are rarely reviewed or challenged. This means that if HMRC carry out a compliance check and decide that the amount claimed was excessive, or had not been incurred by that subcontractor, it will look to recover any under deducted CIS tax from the contractor including interest and penalties.

7. Who owns the plant?

Plant such as scaffolding, cranes, earth-moving equipment, concrete pumps, and compressors are an integral part of any substantial construction project and payments for its hire with an operator are subject to CIS. However, a deduction for purposes of the CIS calculation in relation

to the plant hire only applies where the subcontractor has actually hired the plant from a third party. Where the subcontractor owns the plant (including plant being purchased via a hire purchase agreement) this cannot be treated as a deduction (materials), meaning both the plant hire and labour costs will be subject to CIS.

The treatment of plant as materials is an area to which HMRC will pay particular attention in any HMRC Employer Compliance or CIS reviews so it is imperative that contractors have robust processes and checks in place to be satisfied that the cost of plant hire has been treated correctly. Failure to do so, could leave the contractor with a substantial CIS tax liability, interest and penalties should HMRC find errors.

8. Deemed Contractors - have you spent more than £1 million per year on construction work over the last three years?

This question was applicable to all businesses, not just those involved in the construction industry. If the answer to this question was yes, then the company was considered to be a 'deemed contractor' and consequently would fall under CIS. Conversely, if the annual expenditure dropped below £1 m in each of the three successive years then the business ceased to be considered a deemed contractor. Unfortunately, some deemed contractors started employing creative accounting to try and avoid hitting that £1m plus threshold each year.

In response, new rules were introduced from 6 April 2021 which means that a business becomes a deemed contractor when the cumulative expenditure on construction operations exceeds £3m within the previous 12-month period. Once this criterion is met, CIS must be operated on its next payment to the subcontractor for work that falls within CIS. The key change is that this is a rolling 12-month period so changing year end dates would not work.

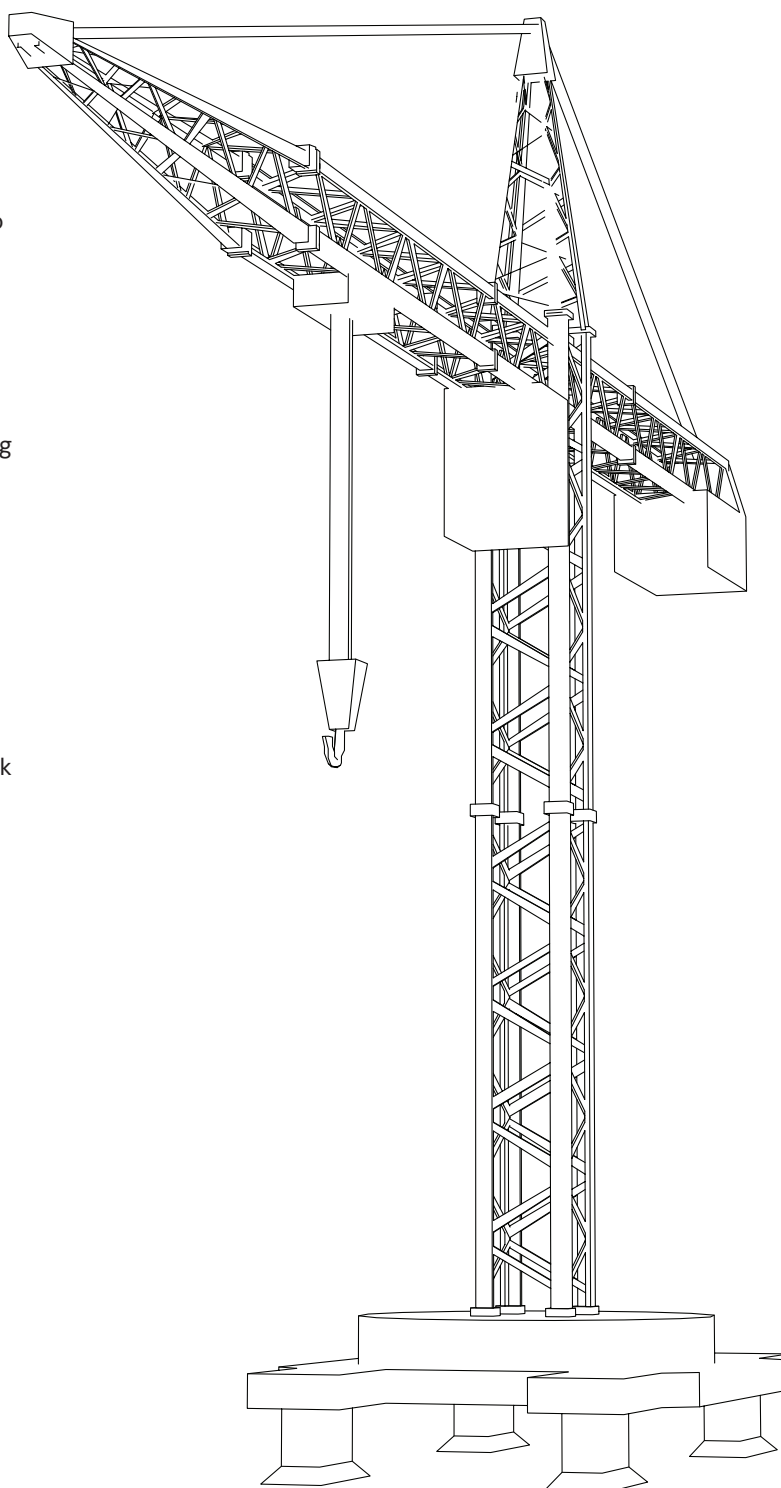
The question of deemed contractor status needs to be considered where any organisation is entering into any significant building or re-development projects.

9. Changes announced applicable from 6 April 2021

- ◆ If the subcontractor undertaking CIS work is a limited company with employees used for the work and have had CIS deductions made, then it can set-off these deductions against its employer liabilities.
- ◆ Unfortunately, this set-off was used incorrectly by some and consequently from 6 April 2021, HMRC can correct the amount of CIS deductions claimed

where it suspects or identifies incorrect amounts have been claimed. Additionally, it can also stop the subcontractor from setting off for rest of the year.

- ◆ The final change targets fraudsters who falsely register under CIS rather than those who may have made a mistake. There is already a penalty that applies for providing false information, but this has been expanded to cover 'anyone HMRC believes is in position to exercise influence and control over the business and/or the person making the CIS registration'. This would include agents, directors etc.



A further point which needs to be borne in mind is whether the IR35 legislation needs to be considered when engaging with any sub-contractors as it will take priority over the CIS legislation.

10. Changes from 6th of April 2024

1) GPS for clients who are sub-contractors and who have GPS, HMRC have introduced several changes effective from this tax year:

- ◆ Sub-contractors with GPS are subject to annual review to decide if they can keep their status. This involves checks on both business and compliance checks and from 6 April 2024 include VAT compliance.
- ◆ HMRC can immediately cancel GPS if there is reasonable suspicion of fraud involving VAT, Corporation Tax, Income Tax, or PAYE.
- ◆ GPS holders will now have their compliance history reviewed six months after applying, and then every year after that.
- ◆ Cancelling GPS can have both commercial (some contractors will only work with subcontractors holding a GPS), reputational and financial (cash flow) implications. If HMRC cancel the GPS, the subcontractor will need to wait a year from the date of the cancellation before they can reapply.
- ◆ Telephone GPS applications are no longer available, except for those who are digitally exempt.

2) Reverse premiums

This involves Landlords making payments to their tenants for construction work, often as an inducement to take up a lease. Category B tenant fit-out payments as inducements have been exempt from CIS. However, category A landlord construction payments are within CIS. This has caused issues for both parties and new legislation was introduced from 6 April 2024 which exempts more Landlord to tenant payments from CIS provided certain conditions are met.

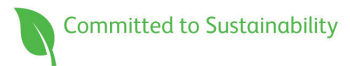
Broadly, the payment must be for construction operations relating to works intended primarily for the benefit and use of the tenant that occupies or will occupy the property under the lease.

However, there is uncertainty about how HMRC will assess whether work is “primarily for the benefit and use of the tenant”.

How can we help?

Please contact our [Employment Taxes team](#) concerning any CIS matters.

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