



factfile

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CONSTRUCTION INDUSTRY SCHEME

Scope of the scheme – FA 2004 s 57(1)

The scheme applies to certain payments under construction contracts which, except in certain circumstances, must be made under deduction of sums on account of tax.

What is a construction contract?

A **construction contract** is a contract relating to **construction operations**, and the parties to the contract are:

- a) a **Contractor**; and
- b) a **Subcontractor**

What are construction operations?

Construction operations are defined at section 74 of the Finance Act 2004. This is a very broad area and the Act only gives definitions rather than actual examples. For a more complete description of what constitutes a construction operation within the meaning of the Act guidance can be obtained from the HMRC website via their own Manuals. Alternatively advice as to whether a particular activity is within the scheme can be obtained from technical support via the HMRC CIS help line.

What is a contractor?

A contractor is a body or person who is either carrying on a business which includes construction operations, commonly referred to as a *mainstream contractor*, or is a deemed contractor by virtue of the fact that average annual expenditure on construction operations in a three year period exceed £1 million. These may include public bodies such as a local authority or an NHS trust.

For deemed contractors expenditure is not a contract payment if the payment relates to work carried out on a property or properties used for the purposes of the business.

However, when deciding whether a body or person is a deemed contractor, you must include all payments, including those relating to properties used for the purposes of the business, to calculate if total expenditure exceeds the prescribed threshold.

What is a subcontractor?

A subcontractor is:

- A party to a contract relating to construction operations; and
- Under that contract he is under a duty to furnish his own or the labour of others in carrying out the operations; and
- Is answerable to the contractor for the performance of those operations.

NB - *A person or body can be both a contractor and a sub-contractor*

What are the obligations of the contractor?

- The contractor must register as such with HMRC and set up a contractors CIS scheme before any payments can be made to subcontractors.
- The contractor must then establish for each worker they engage whether they are an employee or self employed. This is not a new requirement – this has always been the case, however, under the new rules, the monthly return requires the contractor to specifically confirm that he has considered the status of each worker.
- Before making a payment to a subcontractor, the contractor must first verify with HMRC the payment status of the subcontractor. This should only be done when work has been offered to the subcontractor and he has accepted.
- A subcontractor will either be paid gross or under deduction at *the relevant percentage*. The rate of deduction will depend on whether the subcontractor is registered with HMRC and will be based on the payment less the direct cost, to the subcontractor, of any materials supplied by him.
- The contractor should have an adequate audit trail of how the cost of any materials was arrived at in determining the amount of the payment to be subjected to a deduction of CIS.

- Where the subcontractor is to be paid under deduction and is registered with HMRC the relevant percentage must not exceed the basic rate of income tax. Currently the deduction rate is 20%.
- Where the subcontractor is not registered with HMRC or his details cannot be matched the relevant percentage must not exceed the higher rate of income tax. Currently the deduction rate is 30%.
- When verifying subcontractors the contractor will be given a verification number. For those that are registered a single number will be given for all that are verified in a single session.
- For those that are unmatched and liable to deduction at the higher rate a separate verification number will be issued for each subcontractor.
- The contractor must make a return each month detailing all relevant payments made during the period stating to whom they were paid, the payee's personal details such as UTR and National Insurance number and details of deductions made. In the case of subcontractors subject to deduction at the higher rate, the contractor must also include the unique verification number given when verifying the individual.
- As part of the monthly return the contractor must confirm that
 - a) All subcontractors included on the return have been verified.
 - b) None of the subcontractors included on the return were paid under a contract of service, i.e. they were all genuinely self employed.
- The monthly return will run to 5th of the month and must be submitted within 14 days of that date, i.e. no later than 19th of the month.
- The contractor must issue a monthly statement to all subcontractors paid under deduction of tax detailing the period covered, the payment(s) made and the amount of any deductions. This must be issued within 14 days of the month end.
- Deductions must be paid over to HMRC within 14 days of the end of the month, i.e. no later than 19th of the month.

Compliance issues for contractors

- One of the most important features of the new scheme rules is the rolling review of a contractor's compliance record.
- The new rules introduce stricter and more prescriptive compliance criteria to assess if a contractor is fully compliant.

- Late submission of a monthly return will result in a penalty of £100 per 50 subcontractors (or part) per return per month that the return remains outstanding.
- Failure to provide a subcontractor paid under deduction with a statement detailing payments made and deductions could be liable to a penalty of £100 per subcontractor per month.
- False returns could result in a penalty of up to £3,000 per return. In cases of fraud there is the possible sanction of a criminal prosecution and imprisonment.

What are the obligations of the subcontractor?

- A subcontractor will need to register under the scheme when they are about to start work within the construction industry.
- Failure to register at the outset will result in them being paid under deduction at the higher rate – currently 30%
- To register the subcontractor should contact HMRC's CIS Helpline and ensure they have to hand the following:
 - a) Unique Tax Reference (UTR)
 - b) National Insurance number
- If the subcontractor is not known to HMRC there may be a requirement to provide proof of identity.
- If the subcontractor wishes to register for gross payment they will need to satisfy a number of tests before this will be granted:
 - a) **The business test:** the subcontractor must provide suitable evidence that they are carrying on a business that includes construction operations.
 - b) **The turnover test:** the subcontractor must provide evidence that annual turnover from construction operations, net of material costs, is at least £30,000. In the case of a partnership it is £30,000 per partner and for a close company it is £30,000 per each director and shareholder.
 - c) **The compliance test:** the subcontractor must satisfy HMRC that they have been fully compliant with all aspects of their tax obligations for a period of 12 months ending on the date of the application.

Compliance issues for subcontractors

- As indicated in the **compliance test** above a subcontractor who is registered to receive payments gross must be fully compliant with all their tax obligations to remain eligible for gross payment status.
- For individual applicants these obligations will include; their personal tax returns and self assessment payments; if they have employees, it will also include PAYE returns and payments; if they are also a contractor, their obligations in respect of CIS monthly returns and payments of CIS tax.
- For partnerships the conditions relate to the conduct of each individual partner in the firm and each partner, whether an individual or company, must meet their relevant compliance conditions.
- For companies the obligations are similar to those imposed on individuals and partnerships and extend to all directors as well as the company itself. In addition to it's tax obligations compliance also extends to obligations under the Companies Act:
 - a) Filing of accounts complying with the Companies Act within the prescribed timescale.
 - b) Filing returns of directors and secretaries and notification of changes.
 - c) Filing of the company's annual return.
- Non compliance can potentially lead to an enforced change in the payment status of the subcontractor, e.g. from gross payment to payment under deduction.
- **As well as presenting serious cashflow issues, cancellation of gross payment status can have a devastating effect on the business' credibility in their market sector as all customers will be notified by HMRC of the change.**
- Compliance is monitored on an annual rolling programme that is now fully automated.
- There are certain incidences of non-compliance that are ignored:
 - a) Up to 3 monthly CIS returns filed late (up to 28 days)
 - b) Up to 3 CIS/PAYE deductions paid late (up to 14 days)
 - c) 1 Self assessment tax paid late (up to 28 days)
 - d) Any corporation tax paid late (up to 28 days)
- Notice of cancellation of gross payment status is automatic if, in the twelve month period, compliance record does not meet the criteria set.

- HMRC will issue a notice of intention to cancel gross payment status and the contractor has 30 days in which to appeal against this notice.
- For an appeal to succeed the notice must be incorrectly served, i.e. the issues highlighted are incorrect, or there is a reasonable excuse.
- If the appeal is successful then the notice of cancellation is withdrawn.
- If the appeal is unsuccessful notice is then given to all contractors for whom the subcontractor has worked within the past two years that their payment status has changed.
- A business that has lost gross payment status can re-apply once they have no breaches in their compliance record for the twelve period ended on the date of their application.

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