



factfile

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CONSTRUCTION INDUSTRY SCHEME - Part 2

In the previous *Factfile* we looked at the background and scope of the CIS, here we will look at two key aspects that the scheme attempts to address; compliance and status....

In introducing the new rules the Government set three broad aims that a revised scheme should meet, they were:

- To reduce the regulatory burden of the scheme on construction businesses
- To improve the level of **compliance** by construction businesses with their tax obligations
- To help construction businesses to get the employment **status** of their workers right

COMPLIANCE

The scheme requires contractors to make returns of payments to subcontractors and to account for any tax deducted from such payments. To encourage compliance the new rules introduced a number of financial penalties where there are incidences of non compliance.

Monthly returns

Contractors must make a return of all payments made to contractors in a tax month within 14 days of the end of the relevant period. Tax months end on 5th of the month and returns must be filed by 19th. Late submission of a contractor's monthly return is penalised by an automatic monthly penalty of £100 per 50 persons required to be entered on the return or part thereof. This is a monthly penalty and applies to every month the return remains outstanding. For example:

Bob de Bild registered as a contractor with effect from 6 October 2007. He has one subcontractor who he uses occasionally. To date (21 May 2008) Bob has not submitted any monthly returns. There are now 7 outstanding returns and penalties to date stand at £2,800 plus interest where appropriate.

Payment advice for subcontractors

A payment advice must be issued to each subcontractor paid under deduction during the month. The advice should include details of all payments made and tax deducted and must be issued to the subcontractor within 14 days of the end of the tax month. Penalties can be levied if contractors fail to issue an advice and the maximum penalty for breaching this requirement is £3,000.

Incorrect returns

If a return is submitted that is incorrect there is available tax geared penalties in relation to the tax deducted and payments made. However, for genuine errors there will not normally be any penalty. The HMRC website carries a useful summary of errors on returns and how to correct them. These can be found as an appendix to this *Factfile*.

Where the error is due to negligence or fraud then there is a penalty of up to £3,000 per return as well as any tax geared penalty that may apply.

Verification

Before making a payment to a subcontractor, the contractor must have verified the payment status of that person with HM Revenue & Customs. Once the subcontractor has been verified no further verification is required if the next payment occurs within the same or two following tax years and the contractor is entitled to assume the registered status of the subcontractor remains the same unless otherwise notified by HMRC.

Inclusion of a subcontractor on the monthly return who has not been verified or the omission of a subcontractor from the return to whom payments have been made during the month and who has not been verified results in the submission of a false return and is liable to a penalty of up to £3,000.

Status

Each monthly return carries a declaration that "*The employment status of each individual included on this return, and any continuation sheets, has been considered and payments have **not been made under contracts of employment***" If it is established that one or more of the subcontractors are in fact employees and there is no evidence of a review or consideration of each of these workers this would constitute a negligent or fraudulent return and liable to a penalty of up to £3,000. (Status is looked at in more detail below.)

Gross payment status

A consequence of non-compliance can lead to the cancellation of a subcontractor's registration for gross payment. In this respect compliance covers a wider range of issues than those listed above. In the case of individuals the compliance test covers all their obligations under the Taxes Management Act 1970 as well as the specific requirements under the CIS.

For partnerships this extends to every partner and for companies, to every director. In addition, for incorporated bodies, it covers their obligations under the Companies Act in respect of filing accounts, annual returns and directors' details.

HMRC commenced their annual rolling review programme in November 2007 and expect to have carried out a review of all gross receivers within a 12 month period. This is an automated process and will occur annually looking back over the preceding twelve months. There is ample evidence that this process is well under way and that a significant number of subcontractors have been issued notices of cancellation of their gross payment status.

Full details of the compliance test can be found in Schedule 11 of the Finance Act 2004.

Statutory Instrument No. 2045 of 2005 sets out certain exceptions from compliance obligations – these are breaches of compliance that will be ignored in determining whether a subcontractor has satisfied the compliance test in respect of an application for gross payment status. These are:

<i>1. Prescribed obligations</i>	<i>2. Prescribed circumstances</i>
Obligation to submit monthly contractor return within the required period	(1) Return is submitted not later than 28 days after the due date, and (2) The applicant or company – (a) has not otherwise failed to comply with this obligation within the previous twelve months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months
Obligations to pay – (a) the amount liable to be deducted under section 61 of the Act from payments made during the tax period, or (b) tax liable to be deducted under the PAYE Regulations	(1) Payment is made not later than 14 days after the due date, and (2) the applicant or company – (a) has not otherwise failed to comply with this obligation within the previous 12 months, or (b) has failed to comply with this obligation on not more than two occasions within the previous 12 months
Obligation to pay income tax.	(1) is made not later than 28 days after the due date, and (2) the applicant has not otherwise failed to comply with this obligation within the previous 12 months
Obligation to submit a return under regulation 73, 74 and 85 of the PAYE Regulations (annual returns) within the required period	Return is submitted after the due date
Obligation to pay corporation tax for which the applicant or company is liable	(1) Payment is made not later than 28 days after the due date, and

	(2) Any shortfall in that payment has incurred an interest charge but no penalty.
Obligation to submit a self-assessment return within the required period.	Return is submitted after the due date.
Obligations and requests referred to in paragraphs 4(1), 8(1) and 12(1) of schedule 11 to the Act.	The failure to comply occurred before the appointed day and was within section 562(10), 564(4) or 565(4) of ICTA (conditions to be satisfied: minor and technical failures).

Right of appeal

When a notice of cancellation of gross payment status is issued it will be effective from the end of the prescribed period, i.e. 90 days from the date of the notice. The subcontractor does however have the right of appeal and this must be made within 30 days of the date of the notice. Where an appeal is lodged the cancellation is suspended until the appeal is resolved.

Any appeal must set out the grounds under which it is made and will succeed or fail on the strength of the case put. The criteria for compliance or non compliance are quite rigid and well defined and the review is an automated process with no room for manoeuvre.

Firstly you must consider whether the grounds stated by HMRC are factually correct. Check the details and any available evidence that could support a challenge. If the facts are established as being correct then the only other grounds for a successful appeal is that of reasonable excuse.

Re-applying for gross payment status

If a subcontractor should lose their right to receive payments from contractors gross they can apply for re-registration under the scheme as if they were a new applicant. They cannot, however, re-apply for a period of one year after cancellation takes effect.

STATUS

It is the responsibility of every contractor to consider the employment status of each individual worker that they engage. This is essential to ensure the correct operation of the scheme. Remember the declaration on each monthly return:

"The employment status of each individual included on this return, and any continuation sheets, has been considered and payments have not been made under contracts of employment"

This is an extremely vexatious area and one that has tested the courts for over 50 years. Under the current rules contractors are now expected to be experts in employment status law and they are not helped by the fact that there is no statutory definition of self employment.

It is important to stress that the introduction of the new CIS did not herald any change in legislation regarding employment status. It simply made the consequences of not getting it correct more onerous.

To help decide whether the worker is self employed or an employee we must firstly examine the terms of the engagement and review these in the context of the decisions of the courts.

The leading case and one that still decides about 90% of all status issues is that of Ready Mixed Concrete (South East) Ltd v Minister of Pensions & National Insurance – 1968. This case established the *irreducible minimum* requirement for a contract of service (contract of employment) to exist. These are:

1. An obligation to give personal service and mutuality of obligation
2. Sufficient control to make the worker a “Servant of his Master”
3. That no other terms are inconsistent with a contract of service`

This has been further paraphrased as:

- (a) Personal service
- (b) Mutuality of obligations
- (c) Control

All of these must be present to create a contract of employment – the absence of just one of these would point towards self employment. In considering individual engagements we should ask the following questions:

Is the contractor obliged to provide the worker with work?

Is the worker obliged to accept work offered him?

Does the worker have to do the work personally?

Answer no to any of these questions and there is a strong indication of self employment.

HMRC have their own *Employment Status Indicator* tool which can be accessed via their website. This will not provide a binding decision but can be used as an indicator.

It is essential that the contractor does consider the status of each of his workers on a monthly basis and, most important, he maintains a record of that review with sound reasons that support the conclusion reached regarding their employment status.

Once an initial review is undertaken then subsequent reviews may take the form of a simple review of any changes in circumstance or new workers. Again, it is important there is evidence of this review.

The conclusion may be challenged and that challenge may be successful however, provided the contractor has such evidence, he should be in a position to withstand a charge that he has fraudulantly or negligently completed and signed the monthly return(s).

SUMMARY OF TYPICAL CIS RETURN ERRORS AND REQUIRED ACTION

Type of error	What happens next?	The reason for doing this	Comments
You made an error on your return about a payment	Contact us to ask as to amend your return	The original return doesn't reflect the actual payment	
You underpaid a subcontractor	No amendment needed - but you'll need to make up the shortfall in a following month	Both returns will reflect the actual payment - but the subcontractor will want all of their money	
You overpaid a subcontractor net - and you're continuing to use them	No amendment needed if you sort things out in a following month	Both returns will reflect the actual payment - but you'll probably want to square things up with your subcontractor	
You overpaid a subcontractor net, you're not using them any more - but they haven't cashed your cheque	Contact us to ask as to amend your return	The original return doesn't reflect the actual payment situation	
You overpaid a subcontractor net, you're not using them any more - and they've cashed your cheque	Contact us so we can correct the deduction	We need to make sure that everyone's records are correct	
You forgot to take off the VAT before you worked out the deductions	Contact us	Your return reflects the amount you paid, but the subcontractor's record needs correcting	
You got the amount for materials costs wrong	Contact us to tell us about the over-deduction	The subcontractor's records will need updating	We'll repay the subcontractor
You paid the wrong subcontractor - but they didn't cash your cheque	Contact us to ask as to amend your return	The original return doesn't reflect the actual payment situation	
You paid the wrong subcontractor - and they cashed your cheque	Contact us to ask as to amend your return and correct the deduction	The original return reflects the right payment amount but to the wrong person	
You paid a subcontractor for goods not covered by the CIS	If you paid them gross, leave things as they are. Otherwise, contact us to ask us to correct the deduction	The return reflects the actual payment	We'll repay the subcontractor
A subcontractor you paid never cashed your cheque	As long as you made a new payment, you can leave things as they are on the original return		
You made a deduction at the wrong rate	Follow the rules for overpayments or underpayments - as appropriate - and contact us to let us know	The original return should reflect what you actually paid - but it still needs to be corrected	We'll repay the subcontractor