



Construction industry scheme Clause 30 and Schedule 6

Executive Summary

This clause and schedule implement four measures aimed at tackling abuse of the CIS rules. We have significant concerns about two of these:

- The changes to the registration and de-registration rules for deemed contractors lack an evidence base and will create significant new administrative problems.
- The restriction that prevents material costs indirectly incurred by a sub-contractor from being deducted when calculating CIS deductions will cause a huge problem that did not previously exist. It runs counter to the purpose of CIS, which is to ensure tax withholdings on labour and not on materials.

The remaining two measures are reasonable but we believe a right of appeal needs to be added to each of them.

1 Overview

- 1.1 Under the construction industry scheme (CIS), contractors deduct money from a sub-contractor's payments and pass it to HMRC. The deductions count as advance payments towards the subcontractor's income tax and NICs.
- 1.2 This clause and schedule are intended to tackle perceived abuse of the CIS rules by:
 - Amending the rules for determining which entities are deemed contractors,
 - Restricting deductions for costs of materials to cases where the sub-contractor directly incurs the cost,
 - Permitting HMRC to amend the CIS deduction set-off amounts claimed via the PAYE real time information (RTI) system,
 - Expanding the scope of the false registration penalty.

2 CIOT Comments

- 2.1 We are concerned that these legislative amendments are being made at a time when businesses are contending with the challenges of the coronavirus pandemic, are still getting to grips with the challenges of the UK leaving the EU, and are also adapting to the VAT reverse charge on construction operations which has just been introduced.
- 2.2 *Deemed contractors*

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- 2.2.1 Paragraph 2 of Schedule 6 amends the rules for determining when a business, voluntary organisation or public body, which ordinarily would not be a construction industry contractor, is a deemed contractor for CIS purposes. It introduces a new threshold, that when cumulative expenditure on construction operations exceeds £3 million within the previous 12 month period, a business will have to register for the CIS as a contractor (if not already registered) and begin operating the CIS on their next payment to a subcontractor for construction operations.
- 2.2.2 This measure was announced as required to prevent abuse of the deemed contractor rules, but it is not clear to us what abuse of the rules this change is intended to prevent: indeed the change from having an average annual spend over 3 years of more than £1m to exceeding £3m on a rolling 12 month basis is likely to reduce the number of deemed contractors.
- 2.3 *Deemed contractor – registration*
- 2.3.1 The amendments change the point in time at which someone becomes a deemed contractor.
- 2.3.2 The current rules say that a business or public body or charity become a deemed contractor **at any time**, if (a) the average expenditure over three years ending with the end of the last period of account before that time exceeds £1m. So, a business can become a deemed contractor on the first day of the period following the end of the last period of account, and not at some other time during a year. Alternatively, (b) if the entity has not been in business for 3 years, the rules take 1/3rd of total expenditure for the time they were in business, but still measure this to the end of the last period of account before that time. And again, they then become deemed from the first day following the end of that period and not at some other time during a year.
- 2.3.3 Becoming a deemed contractor at these points in time is administratively workable. The business has the benefit of past years accounts, usually audited, as a reliable measure of expenditure, and does not have to continuously measure expenditure during the year with the potential for a sudden in-year change in status.
- 2.3.4 The new rules will cause businesses to (i) have to keep a constant record of expenditure, (ii) make judgements based on unaudited accounts and which may therefore be prone to adjustment, and (iii) will result in a sudden overnight change in status and potential liability.
- 2.3.5 The changes therefore create an administrative problem which the existing legislation is designed to avoid. This runs counter to the simplification agenda, and we do not see what avoidance it will address. In our opinion, the existing regime works well and was designed the way it was for good reasons, whereas the new system will be very difficult for businesses to administer and will create unnecessary compliance errors that do not exist currently.
- 2.4 *Deemed contractors – de-registration*
- 2.4.1 Another area of significant concern is the apparent inability for a deemed contractor to deregister as a contractor once they have exceeded the deemed contractor registration threshold.

- 2.4.2 While the Tax Information and Impact Note states that *'deemed contractors will be able to stop operating the CIS when expenditure on construction operations falls below £3m within the previous 12 month period, or when no further payments on construction operations (including retention or management or administration payments) are expected to be made under that or any other construction contract'* the legislation provides that a deemed contractor may only deregister once the body or person is not expected to make any further expenditure on construction operations. This will be hard to meet, as there is always going to be minor payments for ongoing repairs or maintenance (for example, many local authorities will have ongoing obligations on their own buildings). Consequently this criterion is unlikely to be met and may require a business to remain registered for a longer period.
- 2.4.3 Under current rules if a deemed contractor's spend goes below £1m during each of the 3 successive years in or after a period of account they can deregister. We suggest a similar rule is included in the new legislation such that it makes provision for a de minimis spend on construction operations by deemed contractors, whereby if expenditure over a rolling 12-month period drops below this threshold the deemed contractor can deregister from CIS.
- 2.5 *Cost of materials*
- 2.5.1 Paragraph 4 amends the rules on deduction for materials in FA 2004, section 61(1) such that a contractor, when calculating the amount on which a CIS deduction is to be made, can only make a deduction for material costs incurred directly by the party to which that payment is due.
- 2.5.2 For example, previously an electrical contractor would invoice a site contractor the cost of materials incurred (plus the cost of labour provided etc), and the site contractor would include in its invoice to the main contractor the cost of the materials invoiced by the electrical contractor (plus its own labour costs etc). If the site contractor is not registered gross for CIS purposes the main contractor could deduct the cost of materials when working out the amount on which a CIS deduction is required when paying the site contractor. Under these changes the main contractor will not be able to take account of materials that the site contractor did not directly purchase when determining the amount on which a CIS deduction is required. For the site contractor this means that when settling the electrical contractor's invoice, as the payment received from the main contractor in respect of the upwards charged materials will have been reduced by the CIS deduction, they may be short of funds to pay the electrical contractor!
- 2.5.3 We understand that HMRC's view was that section 61(1) was open to interpretation. In our view, section 61(1) unequivocally permits a deduction for indirect material costs. Therefore, this is a significant legislative change that has the potential to put some businesses at risk (a point that is acknowledged in the Tax Information and Impact Note – the impact on cash-flow means that *'this could lead to ... the failure of some businesses'*, or that *'they may need to lay off some subcontractors'*, and *'could have an impact on family formation, stability or breakdown'*).
- 2.5.4 In our view, this change should not go ahead. The rationale for section 61(1) is clear in excluding the cost of materials: ie. the party being paid will have incurred the full amount of the cost of those materials whether purchased themselves or by a party further down

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the chain. To change this and require a tax deduction for materials not directly purchased will have a material and adverse impact on cashflow. The change will be a huge problem and not only that, it seems it is only a problem that the change in legislation will create. It runs counter to the simplification agenda and is outside the purpose of CIS, which is to ensure withholdings on payments for labour (not materials). In short, it defies logic.

- 2.5.5 If this change does go ahead then some clarity will be required where one party acts as an agent for another party for the purchase of materials. For example, A contracts with B, who sub-contracts with C and B asks C to purchase on B's behalf materials (eg. because C has an account with the local supplier, or has the necessary contacts to obtain a discount, etc). Is B the entity that is directly incurring the cost of the materials in this scenario because C is acting as agent rather than purchasing in their own right? If so, then A can make a deduction for the material costs B invoices for. If not, if B is not registered for gross payment, B will suffer a CIS deduction on the cost of those materials and may then be unable to fully reimburse C/fully pay the supplier.

2.6 *Restrictions on RTI set-offs*

- 2.6.1 Paragraph 6 provides that HM Revenue & Customs can amend or remove a set-off claim by a sub-contractor (who is a company) for CIS deductions suffered to be set-off against PAYE due as a result of RTI submissions. HMRC will also be able to prohibit a sub-contractor from making further set-off claims.

- 2.6.2 While we understand why, in the most egregious cases, it is appropriate to prohibit a person from making a further set-off claim, for a specified period or indefinitely, we do think that any Regulations laid to effect a restriction on set-off should include the right of appeal against the prohibition on making set-off claims (or the length of the period of that prohibition). Similarly, we think that any Regulations requiring information to be given to HMRC should provide for a reasonable period of time for such information to be given (say, at least 30 days).

2.7 *False registration penalty*

- 2.7.1 Paragraph 7 extends the existing penalty regime for false declarations for the purpose of becoming gross registered for CIS purposes to include any person who exercises influence or control over another person, or who is in a position to do so, such that as a result of the first person's influence and control the second person makes a false declaration to obtain gross payment status.
- 2.7.2 We think that this change is fair enough, but believe that the legislation should include a right of appeal such that a defence is available where it can be shown that the person concerned was not involved/had no knowledge of the wrongdoing by the person falsely registering for gross payment.

3 **The Chartered Institute of Taxation**

- 3.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their

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The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

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The Chartered Institute of Taxation
13 April 2021