

development finance, with consequential impacts on housing supply, if standard financing arrangements are treated as falling within CIS².

Introduction and commercial context

Lending activity is an important part of the construction sector. A significant proportion of UK real estate development (both residential and commercial) is dependent on third party development finance. In order to lend responsibly, Standard Finance Facilities for development finance commonly include contractual protections that a prudent lender would adopt to protect its position, such as approval of budgets and development plans, conditions precedent to drawdown, monitoring surveyor sign-off, and restrictions on material variations or disposals.

As an example, the LMA recommended form of real estate finance development facility agreement contains, as a matter of course, both a purpose clause restricting application of amounts drawn under the facility to the acquisition and development of the relevant property, and a suite of property and development undertakings. Those undertakings typically require the borrower to carry out the development with due diligence and in a good and workmanlike manner, in accordance with the building contract, the relevant planning permissions and the agreed development budget and programme; to procure reporting from a monitoring surveyor; and not to make material amendments to the building documents or business plan without the lender's consent. These provisions are protective covenants designed to preserve the value of the lender's security and to control the credit risk of a partly built asset. We understand from members that they are commonplace in development finance. However, it is not the case that these provisions create a legal obligation on the borrower to carry out construction operations in consideration for receipt of the funding – they merely protect the lender from the funding provided being used for general business purposes.

If lenders in the real estate lending market were at risk of being treated as contractors under the CIS, then all finance provided under a facility may fall within the scope of CIS. That position would significantly impact how these agreements are negotiated in the market. Bringing all amounts advanced under a funding facility within the scope of CIS is likely to give rise to a significant and often unanticipated cashflow disadvantage for borrowers. Loans are typically signed shortly before the first tranche is drawn down, leaving very little time for registrations to be processed in advance of a draw down. This is particularly so given the delays experienced by subcontractors attempting to register under the scheme and the difficulties in applying for gross payment registration status.

This is compounded by the fact that such borrowers are frequently special purpose vehicles with limited operating history, which may therefore experience additional difficulty in obtaining gross payment status. In this regard, it is not clear that loan drawdowns would constitute 'turnover' for the purposes of the statutory tests, potentially creating structural barriers to eligibility. This in itself also indicates that it is not correct to treat loan principal payments as contract payments under the CIS save in exceptional circumstances (such as where the loan is intended to be waived from the outset).

We understand that HMRC generally agrees that financing arrangements are not within the scope of the CIS due to the updated guidance in the manual, consistent with the previously understood position, but we are concerned that HMRC's approach to this is not consistent and the policy approach is unclear where the lender retains market standard protections. We would urge HMRC to clarify the position beyond the recent manual update.

Purpose of CIS

The purpose of the CIS, originally introduced by the Finance Act 1971, was to address the evasion of income tax by 'labour-only' subcontractors operating in the construction sector (see Hansard, HC Deb 30 March 1971 vol 814 c1380).

² Development finance is already a live issue for SME house builders, with 60% of SME developers in 2024 considering development finance a barrier to housing delivery, compared to 42% in 2022 :https://www.hbf.co.uk/documents/14137/2024-25_SME_State_of_Play_report.pdf

The scheme has always been targeted at taxable income and operates as an alternative to PAYE for those who are not employed but operate within the construction industry. We suggest the statutory framework should be read in this context.

We note that if advances of loan principal were to be treated as contract payments under the CIS, this would involve amounts that are not taxable income being treated as liable to withholding. That seems very far from the purpose of the CIS and indicates that some more unusual feature (such as loans which are intended to be written off in due course and are so written off) must be present in order to cause a loan advance to be a contract payment. The extract from Hansard above seems to us to reinforce the conclusion that Parliament did not intend ordinary financing transactions, involving no taxable income in the hands of the borrower, to be brought within the CIS.

The statutory framework

The CIS provisions are now contained in Chapter 3 of Part 3 of the Finance Act 2004 (FA 2004) and the Income Tax (Construction Industry Scheme) Regulations 2005 (SI 2005/2045) and apply to payments made under construction contracts.

Pursuant to FA 2004 section 57(2), a construction contract means:

1. one relating to construction operations;
2. which is not a contract of employment; but where
3. one party to the contract is a subcontractor and another party to the contract (the contractor) either is a subcontractor under another such contract relating to all or any of the construction operations or a person to whom section 59 applies.

LMA style facility agreements are not 'contracts relating to construction operations'

Standard Finance Facilities provided to fund development typically contemplate the carrying out of construction operations by the borrower. However, this is not sufficient of itself to mean a facility agreement is a contract relating to construction operations within the meaning of the legislation. The payment flows are typically as follows:

1. the lender provides finance to the borrower to allow the borrower to fund the construction;
2. the borrower, as contractor, makes payments to the borrower's subcontractors to pay for construction operations; and, potentially
3. subcontractors make further payments for construction operations, and materials, down the chain.

The borrower is usually registered as a contractor in respect of the works and the CIS status of the subcontractors will be verified by the borrower. The facility agreement for a development facility will typically require the borrower to ensure it is compliant with its CIS obligations, making developments financed by loans on market-standard terms a very low risk area for CIS compliance.

Development finance facility agreements will also generally include provisions that take account of the construction works that the borrower is undertaking as part of the lender's due diligence of the borrower's activities. A lender operating in any sector will have contractual protection in respect of the nature and conduct of the borrower's business. This is how the lender controls the risk of not being repaid and is not a disguised means of the lender procuring construction works but rather a risk-mitigation strategy which is seen across all lending sectors.

Control exercised over the asset that constitutes collateral for a loan is qualitatively different from control exercised over a supplier engaged to provide services. The former is the management of credit risk; the latter is control over the nature of works being supplied to the payer. These controls are typically negative in nature: they allow the borrower to undertake its business in accordance with what it has told the lender it plans to do (reflecting the basis upon which

the lender has determined that it is prepared to advance the necessary financing) and require consent for deviation from that basis. The borrower is still ultimately in control of the nature and operation of the works. As noted above, the loan agreement does not create a legal obligation on the part of the borrower to carry out construction operations in consideration for receipt of the funding.

We therefore do not consider that Standard Finance Facilities constitute contracts relating to construction operations.

Lenders are not incurring expenditure on construction works by virtue of lending

Under FA 2004 section 59, the definition of contractor includes any person carrying on a business which includes construction operations (commonly referred to as a 'mainstream contractor') and a person carrying on any business if their expenditure on construction operations exceeds £3,000,000 in a rolling twelve month period (a 'deemed contractor').

The lender does not receive the supply of any construction operations in return for the provision of credit. It is not incurring expenditure on construction operations by lending money. The borrower uses the credit provided to incur expenditure on construction operations, but the lender does not. Though the facility agreement will typically contain a clause requiring the borrower to use the funds for the purpose agreed with the lender as part of the lender's due diligence, this is no different to a mortgage provider requiring mortgage funds to be used to purchase the secured property.

Lender 'controls' on the conduct of the borrower's activities

A borrower is not, under a facility agreement, under a duty to the lender to carry out construction operations, to furnish labour, or to be answerable for the works in the sense contemplated by FA 2004 section 58. The developer carries out the development for itself — to hold, let or sell, as the case may be.

The undertakings it gives the lender as to the works exist to protect the value of the lender's security and to ensure the loan is applied for its agreed purpose. They do not constitute a contract under which the borrower provides construction services to the lender, and the lender is not the recipient or beneficiary of the works in the relevant sense.

While we appreciate that the facts of each situation may differ, we suggest that lender controls typically seen in Standard Finance Facilities do not cause a borrower to be treated as answerable to the lender for carrying out the construction works that the facility is funding.

Borrower default

The existence of default remedies, step-in rights, enforcement rights or cure rights does not mean the lender is party to a construction contract while the facility remains an ordinary financing arrangement and there is no default.

There are, effectively, two distinct scenarios:

1. With no default, the lender is merely providing finance to the borrower, with controls to ensure that the borrower used the funds for the agreed purpose – as noted above, the lender is not procuring the construction operations, it is merely providing the funding.
2. Following a default, the CIS analysis will need to be reviewed in the light of what the lender actually does on enforcement. For example, if the lender exercises its step-in rights and steps into the shoes of the borrower as contractor, then payments to subcontractors may then be for construction operations that are within the CIS.

However, we consider that the situation following exercise of step-in rights to be an entirely separate question from whether the lending arrangement per se is liable to the CIS.

Conclusion

Given the concerns we have identified, we request clarification on (and ideally further amendment to) the updated HMRC guidance and HMRC's views on market standard development facility agreements, particularly those based on Standard Finance Facilities. The uncertainty as to HMRC's position is causing issues on live transactions where lenders are seeking protective language and borrowers are not comfortable with the possibility of a significant shortfall on their loan principal as a result of withholding and do not understand why there is concern as to the position. We would be pleased to assist in reviewing draft guidance.

We would welcome:

- confirmation of the principle that standard development finance facilities (including those based on Standard Finance Facilities, with ordinary lender controls) are not construction contracts for CIS purposes
- confirmation that lenders will not be treated as contractors or deemed contractors merely because they provide such finance; and
- amendment of CISR14020 (or a new standalone page) to set this out, ideally with some illustrative examples distinguishing genuine development finance from more contrived arrangements that are, in substance, contracts for construction operations.

Yours sincerely,

Leigh Sayliss

Chair, Property Taxes Committee

The Chartered Institute of Taxation

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- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
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- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
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Appendix

Updated: CISR14020 5 May 2026

Under the heading 'Contract' HMRC's guidance on the meaning of the term 'relating to construction operations' was expanded to state that: 'It may also include situations where a party agrees the scope of works or funds construction operations, even if their primary role is not construction'. (Addition to text highlighted below)

Contract

The expression 'relating to construction operations' is quite broad. Any contract awarded by a contractor that lays a duty on another party to execute, or arrange for the execution of construction operations, or supply labour for such operations, represents a contract relating to construction operations. This applies even if the construction element only forms part of the overall contract. Thus, a contract to supply and install fixed furniture such as a fitted kitchen, for instance, would be regarded as a contract relating to construction operations by virtue of the installation element. It may also include situations where a party agrees the scope of works or funds construction operations, even if their primary role is not construction.

Updated: CISR14020 4 June 2026

HMRC added further text, as highlighted below:

Contract

The expression 'relating to construction operations' is quite broad. Any contract awarded by a contractor that lays a duty on another party to execute, or arrange for the execution of construction operations, or supply labour for such operations, represents a contract relating to construction operations. This applies even if the construction element only forms part of the overall contract. Thus, a contract to supply and install fixed furniture such as a fitted kitchen, for instance, would be regarded as a contract relating to construction operations by virtue of the installation element. It may also include situations where a party agrees the scope of works or funds construction operations, even if their primary role is not construction. Any arrangement that amounts in substance to the procurement of construction operations will fall within the scope of CIS. An example of this would be where a business agrees the specification for repair works and pays for those works to be carried out on behalf of another party. Even though the main purpose of the arrangement is not construction, the agreement to have construction operations performed brings the contract within the scheme. Pure financing arrangements (including lending, providing finance and grant funding) fall outside the scope of CIS.