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Construction Industry Scheme: Landlord contributions to tenant works

Submission by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

1.2 The Construction Industry Scheme (CIS) requires a contractor to withhold tax from payments to subcontractors for certain construction work. The aim of the Scheme when introduced (in 1972) was to counter the black economy that was perceived to exist in the industry and improve compliance.

1.3 The scope of the Scheme means that it may extend to landlords making payments to tenants (in non-construction sectors such as hospitality, retail or tech) who are carrying out construction works to finish a building or to fit it out to their own specification, a practice that is increasingly common. If the works fall within the Scheme (and whether they do is far from clear) the tenant either has to register for the CIS as a subcontractor or receive the payment under deduction of tax and claim it back from HMRC. Typically tenants are not physically carrying out the works themselves but rather sub-contracting works to third party contractors. At that stage the CIS rules operate as intended to capture actual construction operations. It is the application of CIS between tenant and landlord for the same works that adds legal and administrative costs and adversely affects cash flow for start-up businesses that may not have sufficient payroll costs to offset the CIS deduction. Businesses expanding into the UK that do not have a trading history cannot register under CIS for gross payment status. Non-construction businesses will generally not have had any exposure to CIS before so the CIS deduction will not be anticipated.

1.4 Anecdotally we understand smaller retail/hospitality businesses on the high street end are particularly impacted by the application of the Scheme to landlord contributions to them as tenants because of the uncertainty of its application depending on the category of work undertaken and delays in obtaining a refund. Removing these adverse consequences would therefore appear consistent with the government's policy of promoting resilient thriving high streets and town centres of the future .

1.5 The application of the Scheme to landlord contributions does not appear to reflect the CIS policy intent and can be both complex and uncertain. We suggest consideration should be given to a wider exclusion to remove from CIS all contribution payments made by landlords to tenants in connection with the grant, variation or assignment of a lease whether for tenant's fit out or for landlord's works, possibly with an anti-avoidance provision to address any perceived risk of misuse of the wider exemption.

2 About us

2.1 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 advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3 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.

2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

3 Introduction

3.1 This submission updates our earlier submission (in 2017[1]) on the longstanding issue of the application of the Construction Industry Scheme to landlord contributions to tenant works. Both this submission and the earlier submission are part of our ongoing engagement with HMRC over more than six years, together with other professional bodies and industry, to highlight the administrative burdens and adverse cash flow implications for business on contributions that do not appear to fall squarely within CIS policy objectives.

3.2 The Construction Industry Scheme (CIS) requires a contractor to withhold tax from payments to subcontractors for certain construction work. The aim of the scheme when introduced (in 1972) was to counter the black economy that was perceived to exist in the industry and improve compliance. The Scheme was last revised in 2007 with the policy aims of:

- Making it easier for businesses to comply with their income tax obligations, and;
- Reducing the regulatory burden through making the scheme simpler to administer.[2]

3.3 Finance Act 2021 includes measures[3] to tackle abuse of the CIS regime and fraud in supply chains. Up to 5 April 2021 non-construction businesses spending over £1 million on construction operations, averaged over

[1] https://www.tax.org.uk/ref244
[2] The policy aims were set out in the HM Revenue and Customs Research Report 106 'Evaluating the Construction Industry Scheme' in October 2010 – see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/344922/eval-cis.pdf
[3] FA 2021 section 30 and Schedule 6

three years, were deemed contractors for CIS purposes and required to operate the CIS. Subject to transitional rules, from 6 April 2021 this limit is increased to £3m per annum applied over a rolling 12 month period.

3.4 The scope of CIS means that it extends (or it may extend) to landlords making payments to tenants where tenants have contracted to carry out construction works, unless the payments fall within the definition of reverse premiums. Landlord contributions to tenants for landlord works (Cat A[4]) and landlord contributions to tenants for tenants works (Cat B), or a combination of both, are increasingly common as landlords work more closely with tenants to assist them in obtaining earlypossession and/or to model space to suit their needs instead of tenants having to remodel the building. Landlord contributions are negotiated for commercial expediency and efficiency to facilitate early possession providing time, cost and environmental benefits.

3.5 Although the reverse premium exclusion provides an exemption for landlord to tenant payments for tenants' fit-out works, it is of limited and often uncertain application. To fall within that exception, the relevant payment must be a pure 'inducement' in connection with a transaction being entered into by that person or a connected person eg in connection with a tenant entering into a lease.

HMRC's guidance for CIS purposes does not elaborate on the meaning of inducement for CIS purposes, but provides links to the Business Income Manual (BIM). For example, BIM41075 provides a number of examples of payments that HMRC considers to be inducements which are taxable reverse premiums. These will also be reverse premiums for CIS purposes. However, the BIM does not make it entirely clear, which payments can be reverse premiums for CIS purposes despite not being so for business income purposes. The most obvious example is at BIM41090 which does not cross refer back to the CIS Guidance explaining that the exclusions in the BIM are not relevant for CIS. This could lead a reader to assume that reverse premiums in these circumstances fall within CIS when in fact they may not.

3.6 Our stated objectives for the tax system include:

- 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.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- Responsive and competent tax administration, with a minimum of bureaucracy.

4 Payments by a landlord to a tenant – CIS framework

4.1 The current legislative framework for CIS is in Part 3 Chapter 3 of Finance Act 2004 and the Income Tax (Construction Industry Scheme) Regulations 2005 SI 2005/2045 (as amended) ('the Regulations').

[4] Category A and Category B works are non-statutory terms used in the industry. Category A works are often also described as a landlord fit out to prepare a building so that it's ready for a tenant (for example , basic lighting and sockets, suspended ceilings and raised floors, basic finishes to internal walls). Category B works completes the fit out of the internal space to the tenant's requirements and might include interior design and branding, acoustics, partitioning and doors, technology infrastructure and installation and cafes, kitchens and bathrooms.

4.2 Payments fall within CIS if made under a construction contract defined in FA 2004 section 57 as a contract relating to construction operations (which is not a contract of employment) where one party is a subcontractor and the other is a contractor.

4.3 Where a tenant carries out work to premises and the landlord makes a contribution towards the tenant's expenditure, a landlord may be a contractor because the extended definition of a contractor in FA 2004 sections 57 and 59 (as amended with effect from 6 April 2021[5]) includes a business with construction expenditure on construction operations that exceeds £3 million per annum over any rolling twelve month period or a specified public body such as a local authority as well as a mainstream contractor (someone whose business includes construction operations). In this context we note the guidance at CISR12080 stating HMRC's view that 'build to rent' investors may be contractors for these purposes thereby extending the ambit of the types of landlords potentially falling within these provisions.

4.4 Similarly the term 'subcontractor' is considerably wider than its normal usage in the construction industry. To fall within the definition of sub-contractor under FA 2004 section 58, it is sufficient that the tenant is merely 'under a duty' to do the works or procure that they are done or is 'answerable' to the landlord in respect of them.

4.5 The definition of 'construction operations' is very wide extending beyond building structures and includes (as defined in FA 2004 section 74) not only altering and repairing buildings but also installing heating and lighting systems and painting or decorating the outside or inside of a building.

4.6 Where a contract includes some work that is within CIS and some that has nothing to do with construction, HMRC treat all payments made under the contract as falling within CIS.

4.7 It is irrelevant where the contractor and sub-contractor are resident or where payments are made.

4.8 If a payment or payments falls within the CIS, the landlord is required to withhold tax at the relevant percentage (30% or 20% depending on the sub-contractor's registration status) from the payment to the tenant unless the tenant is registered under the CIS to receive payments gross.

5 Reverse premium – exclusion from the CIS

5.1 The reverse premium exclusion from CIS is a longstanding exception aimed at removing payments by a landlord to a tenant from the scope of CIS. However the exclusion (regulation 20 of the Regulations) is limited in its scope applying only where the payment to the tenant is treated as a reverse premium under Corporation Tax Act 2009 section 96 (previously Finance Act 1999 Schedule 6 now repealed[6]) or ITTOIA 2005 section 99, subject to Reg 20(2). For CIS purposes only, Reg 20(2) disapplies the cases which are excluded for corporation tax purposes by CTA 2009 section 97 and for income tax purposes by ITTOIA 2005 section 101.

5.2 A reverse premium for the purposes of CTA 2009 section 96 and ITTOIA 2005 section 99 is a payment that meets all the following conditions :

- The payment is received by way of inducement *in connection with* a transaction entered into by the recipient (or a connected person).

[5] Up to 5 April 2021 a non-construction business had to operate CIS if its expenditure on 'construction operations' exceeded £1m per annum, averaged over three years. Subject to transitional rules, from 6 April 2021 FA 2021 Schedule 6 paragraph 2 increased this limit to £3m per annum with the test applied when cumulative expenditure on construction operations exceeds £3M within the previous 12 month period.

[6] Regulation 20 should be updated to reflect the fact the relevant legislation is now at Corporation Tax Act 2009 section 96

- The transaction is one by which the recipient (or connected person) becomes entitled to an estate, interest or right in or over land.
- The payment is paid by the person granting the estate, interest or right (or a connected person or nominee acting on the directions of either the recipient or the connected person.

As noted above, for CIS purposes, where payments are not taxed as reverse premiums because they are treated as contributions to expenditure on which the tenant would have been entitled to claim allowances (but for the restriction in the capital allowances rules on contributions), the exclusion from CIS can still apply (regulation (20(2)).

5.3 Where a payment is being made in connection with the grant of a lease and the tenant only carries out basic tenant fit out works, it should be possible to rely on the reverse premium exemption.

However, if the payment is for Cat A works that are the responsibility of the landlord or would otherwise have been carried out by the landlord (save for the express agreement with the tenant), it is not entirely clear if this could be or can never be a reverse premium. For example, that a tenant might be induced to enter a lease and the landlord might derive some benefit at the same time, does not appear mutually exclusive in the legislation. The legislation simply refers to payments by way of an inducement in connection with a transaction. There are in fact numerous examples in landlord/tenant scenarios where it does not apply or where it is not clear whether or not it applies to works such as back-up generators, air-cooling, roof terrace enhancements and other improvement works. (See the examples provided in the evidence at Appendix 2).

6 Problem areas – identification of works

6.1 A common problem area is where the tenant's works are not clearly identifiable as basic tenant fit-out works. This difficulty arises from the requirement that, to be a reverse premium for tax purposes, the payment by the landlord must be an 'inducement' to the tenant to take a lease. BIM41075-41090 sets out HMRC's views on the meaning of this term in this context. BIM41085 indicates that HMRC regard a landlord's contribution to tenant fit-out costs as being a reverse premium. However, the guidance distinguishes between:

- the cost of providing such fittings as are necessary to make a building ready to let (not a reverse premium) and
- the cost of meeting what are properly the tenant's expenses of fitting out (a reverse premium).

The guidance provides two rules of thumb (in bold) to assist in making the distinction:

'It should usually be clear what expenditure procures a finished building and what represents tenant's fitting out costs. ***As a rule of thumb, the latter will not increase the value of the reversion, because it will be worthless to the landlord when the lease ends. An example would be shop counters. Another rule of thumb is that expenditure on fitting out costs will not fall to be taken into account in fixing market rent on a rent review. (Our emphasis)*** *In the roof example, the installation of a roof, which will remain of value to the landlord when the lease ends, will enhance the value of the reversion and affect the outcome of a rent review.'*

It is not always easy to make the distinction put forward in the guidance, and as noted above at 5.3, neither is it clear that the legislation makes such a distinction. For example, tenants often install air conditioning systems within the building as part of their fit-out but would such works fall within the first or second category? Why does it matter and why cannot both parties derive some benefit?

6.2 As a practical matter, it is common for tenants to combine tenant fit-out works with some more structural elements because it is simply not practical to have two different sets of contractors working on site simultaneously. Alternatively, tenants often prefer to have control over some elements (using their own building contractors) that might more usually be carried out by or on behalf of the landlord.

6.3 Sometimes tenants themselves wish to make alterations to the building to suit their own purposes. In such cases the landlord may make a contribution but the works are being carried out at the instigation of and for the benefit of the tenant rather than the landlord.

6.4 A recent article in Tax Adviser 'Construction Industry Scheme – A candidate for simplification' describes and expands upon the difficulties faced in practice (see Appendix 1).

6.5 To be a reverse premium, it is necessary that the payment is made in connection with a property transaction between the recipient (or a person connected with the recipient) and the landlord. In BIM41105 and BIM 41110, HMRC indicate that the inducement must be in connection with the grant of a lease. Therefore, contributions would not be within the reverse premium exemption if paid, for instance, in connection with a change of the terms of an existing lease (eg a variation to the rent) or if paid by the landlord to an assignee (eg if the existing tenant becomes insolvent and the landlord wants to induce the assignee to step into the shoes of the tenant).

BIM41105 also explains that an inducement to buy a freehold is not a reverse premium because the payment must be made by the person by whom the estate interest or right is granted, and a freehold cannot be granted. The legislation refers at Condition C to the payment being made by the person by whom the estate (or interest or right) is or was granted. An interest or right clearly includes a leasehold, but if a freehold cannot be granted, what does the 'granting of an estate' mean where it is used in the legislation?

7 Business burdens

7.1 In our members' experience, where these issues arise - commonly in the retail and hospitality sectors - the question of the application of CIS may not be identified until a fairly late stage, if at all. For tenants who are, or could be, affected, obtaining a gross payment registration can take some time and is often impossible to achieve within the transactional timetable.

7.2 If the reverse premium exemption does not apply, it will be necessary to undertake detailed investigations to ascertain whether the landlord is or could be a deemed contractor and to identify the nature of works. Accordingly, landlords are forced into adopting an overly-cautious approach and apply CIS by default, at the expense of tenants because incorrect classification results in disputes with tenants and potentially significant tax liabilities and penalties.

7.3 Administratively, registering as a sub-contractor is a significant burden on tenants outside the construction industry in totally unrelated industries. One member notes that they deal with tenants that are mainly tech companies or in media and publishing. For such companies, registering as a subcontractor is time consuming and costly involving instructing advisers to apply on their behalf. Such tenants are not physically carrying out the works themselves but rather sub-contracting such works to a third party contractors. At that stage the rules operate as originally intended capturing construction operations. It is the application of the Scheme between tenant and landlord for the same works that seems outside the policy intent and operates to add legal and administrative costs , adversely affects cash flow and comes as a surprise to start-up businesses and businesses expanding into the UK that are non-construction businesses and therefore have had no exposure

to the Scheme beforehand. In the case of a start up business or tech company they may not have the payroll capacity to offset the CIS deductions and often have to wait for a refund or offset against corporation tax.

7.4 Additionally, obtaining gross status is far more difficult if tenants are setting up business or expanding into the UK as they will not have a trading history. Similar difficulties may be encountered where single special purpose vehicles are used which are not within a group.

8 Evidence of the extent of the problem

8.1 Included at Appendix 2 is recent evidence of the issues encountered by some of our members. Evidence from our members is inevitably limited by membership numbers and would require extrapolation or a formal call for evidence to determine the full extent of the issue. However the response has demonstrated that the issue continues to provide a significant and often unanticipated business burden.

8.2 Anecdotally we understand smaller retail/hospitality businesses on the high street end are particularly impacted by the application of the Scheme to landlord contributions to them as tenants. Smaller businesses are less likely to be aware of CIS so less likely to have registered as a subcontractor. The potential consequences are:

- They have higher withholding – 30%.
- They may not have sufficient payroll to recover in the same month; this is more likely in hospitality where contributions are larger and the tenant may have no or few employees until they open (after fit out).
- They will have cash flow issues in being able to pay their contractors as they have not received the full amount of the landlord's contribution.

Removing these adverse consequences would therefore appear consistent with the government's policy of promoting resilient thriving high streets and town centres of the future[7].

9 Conclusion and our suggestion

9.1 Our stated objectives for the tax system include a legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences. The application of the Scheme in the circumstances described does not appear to reflect the policy intent. Our understanding of the CIS policy objective is to address the exchequer risk at the point where the building contractor physically carries out the construction works on behalf of the tenant. Payments between landlord and tenant are for the same works.

9.2 The application of the CIS scheme also raises concerns in relation to two of our further objectives. The tax system should aim to provide simplicity (so far as possible) and clarity, so businesses can understand how much tax they should be paying and why. However, the application of the Scheme in these circumstances is often unclear and sometimes unexpected because tenants in the sectors typically affected have had no reason to consider the Scheme before as they are not in the construction industry.

[7] Levelling Up White Paper https://www.gov.uk/government/publications/levelling-up-the-united-kingdom

9.3 The tax system should operate a responsive and competent tax administration, with a minimum of bureaucracy. In these circumstances however start-ups and owner-occupied businesses may struggle to immediately offset the CIS deduction against payroll due to insufficient capacity - causing cash flow difficulties and sometimes, in the case of inward bound tenants issues of recoverability at all.

9.4 Professional bodies and industry engaged extensively with HMRC in 2018 to seek to improve the CISR manual reverse premiums guidance in in order to provide greater certainty on its application. As a result the guidance was improved to some extent but significant uncertainties remain. The guidance cannot address every scenario and, more fundamentally, it cannot extend the limited exemption in regulation 20.

9.5 Given the wider policy intent of the Construction Industry Scheme, we suggest that consideration should be given to a extended statutory exclusion to remove from CIS all contribution payments made by landlords to tenants in connection with the grant, variation or assignment of a lease whether for tenant's fit out or for landlord's works. It would be possible to restrict access to the exemption to address any concerns that a non-commercial lease may be put in place between connected parties to circumvent CIS. The intermediaries exception for the VAT reverse charge for supplies are made in relation to land, buildings or civil engineering works in which both the intermediary supplier and the expected end user of those services have a relevant interest (such as landlords and tenants)[8] may assist in providing an appropriate model given the shared policy objectives of preventing avoidance in relation to business-to-business supplies of construction services.

Alternatively, and less ideally, a full exemption could be provided but with an obligation to notify on the landlord.

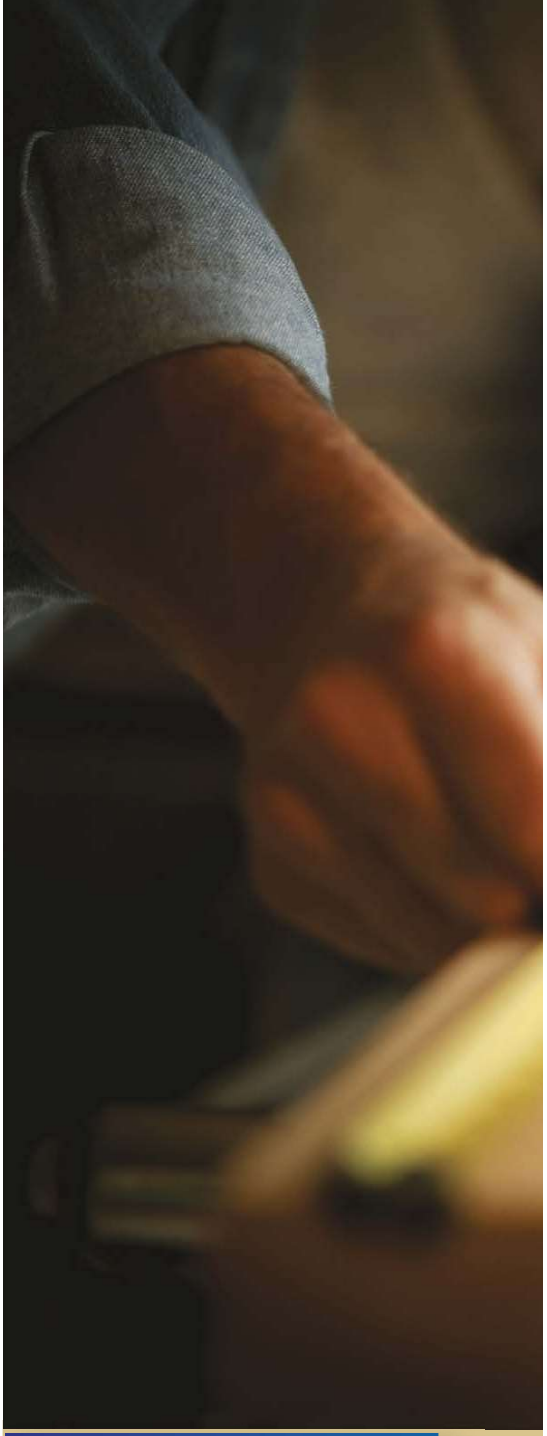
9.6 Providing a wider exemption with any suitable safeguards would not appear to offer a permanent cost to the exchequer as revenue collected from deductions is ultimately recovered by the taxpayer through payroll or at the year end.

The Chartered Institute of Taxation

3 May 2022

[8] The Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019 Article 8(1)(b)(ii)(bb) and Article 2(b)(ii)

CIS simplification
Time for renovation?



by David Westgate

A number of Construction Industry Scheme reforms could result in tax simplification, benefiting landlords, tenants and HMRC. We take a look at three areas which are ripe for review.

The purpose of this article is to highlight three areas ripe for review in relation to the Construction Industry Scheme (CIS).

1. CIS implications of landlord contributions to tenants

Landlord contributions to tenants for landlord works (Category A) and for tenant works (Category B) are becoming more common. Landlords are now collaborating more with tenants to assist them in obtaining early possession and in modelling space to suit their needs, rather than remodelling what they are presented with by landlords. This has time, cost and environmental benefits. For CIS purposes, the key issue is that the landlord may need to withhold tax from Category A payments to a tenant if the tenant is not registered for gross payment under the scheme. Incorrect classification of contributions results in disputes with tenants and potentially significant tax liabilities and penalties.

From a CIS perspective, there is no statutory definition of what constitutes Category A and Category B works. Most works fall into one of those categories but the identification problem pertains to the 'grey' area in between. Both the landlord and the tenant will need to agree the categorisation of these grey areas, which could include back-up generators, roof terrace enhancements or additional air-cooling requirements, for example.

Often, the proposal for allocating costs between Category A and Category B will be influenced by the tax and accounting treatment of both the landlord and tenant, so their initial analysis may reflect these influences.

This article addresses the issues pertaining to Category A works, as this is the area that is problematic from a CIS perspective.

Application of CIS to Category A works

The main commercial drivers for making contributions to tenants' works are efficiency, and improving timing to facilitate early possession.

A tenant may wish to start their own works prior to or at the same time as the landlord's Category A works. In this case, a landlord may agree that the tenant can use their own building contractors to carry out or finish the landlord's works in conjunction with their own Category B works. Dovetailing the works is more efficient and ensures that the works are carried out to a consistent standard.

Alternatively, the tenant may require a higher specification for their own purposes and wish to enhance a particular area over and above the standard specification, using their own building contractors.

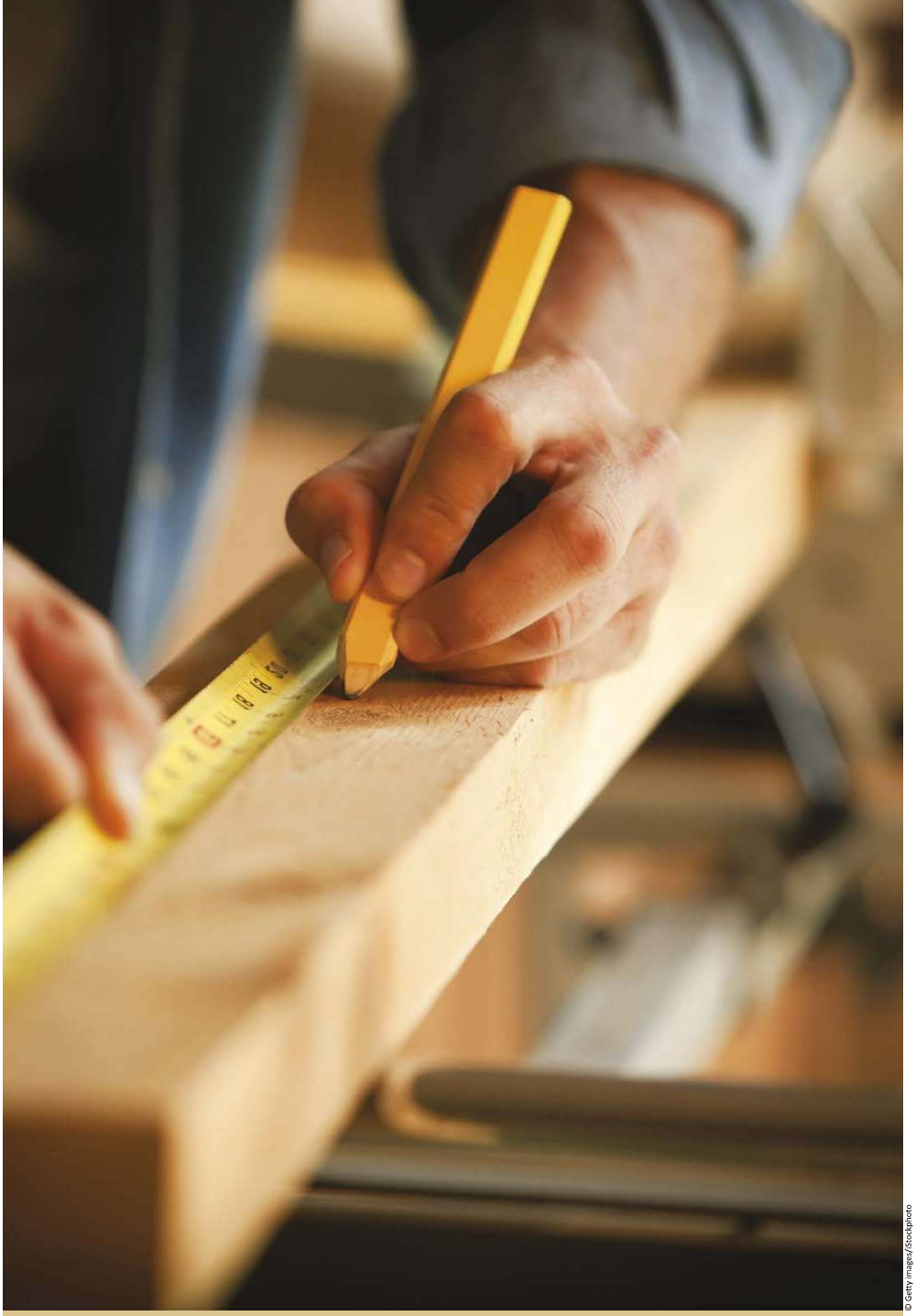
Payments fall within CIS if they are made under a construction contract, defined in Finance Act 2004 s 57 as a contract relating to construction operations (which is not a contract of employment) where one party is a sub-contractor and the other is a contractor. As things currently stand, the tenant (as sub-contractor) in receipt of a Category A contribution must undertake to comply with the requirements of the CIS scheme under Finance Act 2004 Part 3 Chapter 3 and the Income Tax (Construction Industry Scheme) Regulations 2005 (SI 2005/2045) ('the Regulations'). The tenant will either be registered for gross payment or subject to deduction of tax at the relevant

Key Points

What is the issue?
Landlords are now collaborating with tenants to assist them in obtaining early possession and in modelling space to suit their needs, rather than remodelling what they are presented with by landlords.

What does it mean to me?
For Construction Industry Scheme purposes, the landlord may need to withhold tax from Category A payments to a tenant if the tenant is not registered for gross payment under the scheme.

What can I take away?
The CIS rules place a significant burden on tenants, the majority of whom are not in the construction industry but rather unrelated industries.



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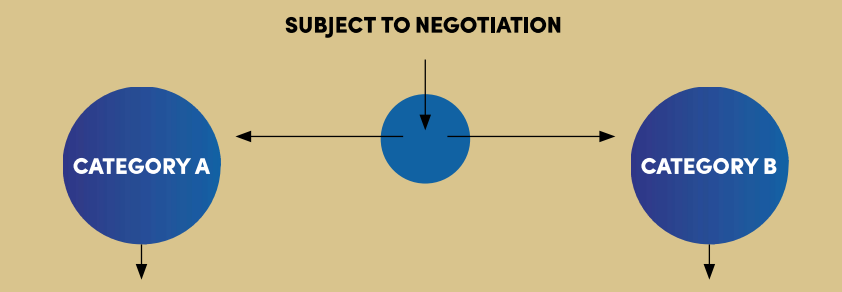
WHAT CONSTITUTES CATEGORY A AND CATEGORY B WORKS?



- Raised floors and suspended ceilings
- Mechanical and electrical services
- Internal surface finishes
- Basic fire detection systems

- Final finishes and branding
- Installation of specialist facilities
- Fitting out reception areas
- Installation of specialist lighting, etc
- Fit out of kitchen areas

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percentage stated under the scheme rules under Finance Act 2004 s 61.

Notwithstanding the above, certain payments are excluded from the rules, in particular:

- If the payment from the landlord to the tenant is an incentive to enter into the lease: This is a reverse premium (or would be a reverse premium but for the capital allowances carve-out) under regulation 20 of the Regulations. Most Category B items are taxed as reverse premiums in the tenant's hands and therefore outside the scope of CIS under this regulation.
- If the tenant is not contractually obliged to do the work, they would not then be a 'sub-contractor' (Finance Act 2004 s 58): Sometimes the landlord will allow this even for Category A contributions, relying on a combination of commercial reality (as the tenant will want to do the works) and the rent review clause.

Impact of the CIS rules on tenants

The CIS rules place a significant burden on tenants, the majority of whom are not in the construction industry but rather unrelated industries, including hospitality, technology, and media and publishing, to name a few. For companies such as these, registering as a sub-contractor for CIS (in order to receive gross payments from the landlord) is time consuming and costly. Due to the complexity of the rules, they will often ask their legal teams or accountants to make the application to register as a sub-contractor on their behalf.

An inordinate amount of time and money can also be spent by the landlord and tenant agreeing legal wording to ensure that the contributions are identified, categorised and invoiced correctly. In the event that a tenant is not registered for gross payment as a sub-contractor, the landlord's right to deduct must be properly documented.

Obtaining gross payment status can be difficult for tenants setting up a business or expanding into the UK for the first time because they will not have a

trading history. In the absence of obtaining gross payment status, a tenant will be subject to deduction of tax at either 20% (if registered) or 30% (if not registered), which can lead to severe cash flow problems:

- Start-ups and owner-occupied businesses may struggle to recoup the CIS deduction against relevant liabilities because they do not have the payroll capacity to offset the amounts. They will often have to wait until the end of the tax year for the deduction to either be refunded or offset against any corporation tax due.
- Tenants may need to pay their sub-contractors in full but due to the CIS deduction being applied on the payment from the landlord, they will have a shortfall which they will have to fund until they are repaid by HMRC.

In many cases – especially the hospitality sector, which has suffered more than most during Covid – the cash flow problem created by the CIS deduction can result in protracted negotiations between the parties as they attempt to mitigate the impact. Some of these mitigation measures include:

- a change in the works specification;
- the tenants having to secure additional funding; and
- in extreme cases, the landlord funding the shortfall on behalf of the tenant.

All three situations result in delays to the tenant commencing operations from the property.

Caught in the middle

When a landlord makes a contribution to a tenant to carry out works, the tenant in most cases is not physically carrying out the works but sub-contracting them to a third-party building contractor.

The tenant may not qualify as a deemed contractor, such that any payments they make to the building contractor are not deemed to be CIS 'contract payments'. That is because of the exemption under regulation 22 of the Regulations for 'own build' works, which applies where:

- the expenditure is in respect of works to their own premises;
- the property is 'used for the purposes of the business of [the tenant]'; and
- at the point when the tenant makes the payment, they have incurred more than £3 million on construction operations in the past year.

Thus, the effect of regulation 22 can be that the tenant does ***not*** have to apply CIS when they make payment to their building contractor for works carried out at the start of the lease (regardless of the nature of the works).

The interposition of the tenant between the landlord and the tenant's third-party building contractor can mean that the tenant has to suffer a deduction from a payment from the landlord but will not be able to make a deduction from payments to the third party because regulation 22 applies. It is this asymmetry in treatment which creates a cash-flow difficulty. Even where regulation 22 does not apply to a particular payment, perhaps because the tenant has not at that point passed the £3 million threshold, there would still likely be asymmetry in the treatment if the tenant's third-party building contractors were registered for gross payment.

The mischief the rules were originally intended to capture should only be a concern in relation to the building contractor physically carrying out the construction works on behalf of the tenant. Applying the scheme to payments between landlord and tenants for the same works seems to be outside the original policy intent.

2. CIS grouping

The concept of grouping does not currently exist for CIS, so a large group company must register all subsidiaries individually for CIS (assuming they are deemed or main contractors). The compliance burden in having to report each subsidiary is significant in terms of administration time, such as collation of data by each company, verifying the same sub-contractor, making withholding tax payments and online filing for each company.

Introducing a group CIS return to ease the administrative burden in a similar vein to VAT grouping (where you nominate a representative member with joint and several liability for all members of the CIS group) would seem a sensible solution.

Submitting one CIS return under one PAYE reference is not only administratively beneficial for businesses but also for HMRC.

3. Intragroup transactions

CIS also applies if one company in a corporate group acts as a developer under a development management agreement providing services to another group member. The company providing the services to another group member will have to register as a sub-contractor and additionally function as a deemed/mainstream contractor in respect of the contracts it operates with 'genuine' third party contractors.

For the same reasons as above, it seems to be outside of the original policy intent that the rules should apply within a corporate group. The revenue is protected because of the requirement for a group member, acting as a developer, to register as a deemed/main contractor (subject to any exclusions) when dealing with the third-party building contractors. This scenario is administratively burdensome, and another example of where innocent transactions are caught under the scheme because the CIS net is cast too wide.

The way forward

These issues should be at the front of the queue for consideration by HMRC as an easy-win tax simplification measure.

Members in industry and the profession are engaging with HMRC. If you would like to assist in making a positive change to the existing CIS rules, please see the note in *Tax Adviser* by the CIOT's Kate Willis, 'Construction Industry Scheme: landlord contributions to tenant works' (see bit.ly/3wNmBqu), where there is an email address for correspondence.