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Construction Industry Scheme (CIS) proposed amendments

Response by the Chartered Institute of Taxation

1 Introduction and 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 Our comments on the proposed amendments to the Construction Industry Scheme (CIS) regulations, which set out exceptions to VAT compliance obligations to ensure that Gross Payment Status (GPS) is not refused or removed for minor errors, and exempt certain payments from landlords to tenants from the scope of the CIS, are set out below.

1.3 We welcome the proposals to exclude minor VAT non-compliance issues from being taken into account in the GPS compliance test and would suggest a post-implementation review to consider how successful the exceptions from compliance obligations have been in retaining or obtaining a sub-contractor's GPS.

1.4 We also welcome the proposals to remove the majority of Landlord/Tenant payments from the scope of the CIS. However, we think that the proposed legislation could be improved to ensure that this change meets its policy objective.

1.5 We suggest including a definition of a lease agreement in the legislation such that it includes the lease, an agreement for lease, a side letter, an agreement for variation or extension of a lease and a licence for alterations.

1.6 We do not think it is necessary to define a landlord in the regulations and that it would be better if the term had its natural meaning. This said, we welcome the confirmation that tenant includes a sub-tenant.

1.7 We also suggest relaxing the requirement for construction obligations to relate exclusively to parts of the property that the tenant occupies or will occupy under the lease agreement, as there will be cases where the works carried out by the tenant will, for practical reasons, extend beyond the demise of the tenant's premises.

1.8 We would also welcome confirmation that the new rules on landlord/tenant payments will apply to payments falling within scope of the CIS that are made on or after the commencement date, rather than leases/agreements for lease etc entered into on or after that date.

1.9 We consider that the changes we suggest to the draft regulations implementing the exemption from the CIS for payments from a landlord to a tenant would help to better achieve the purpose behind these proposed changes, and would reduce the CIS burden on both HMRC and taxpayers in relation to payments that should not fall within the intended scope of the CIS.

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 Construction Industry Scheme (CIS) proposed amendments – CIOT comments

3.1 We set out below our comments on the draft regulations amending the Income Tax (Construction Industry Scheme) Regulations 2005 ('the 2005 Regulations') to:

- ensure minor VAT compliance failures will not result in Gross Payment Status (GPS) refusal or removal, and
- remove most payments made by landlords to tenants from the scope of the CIS.

3.2 ***Exception for minor VAT compliance failures***

3.3 Draft regulation 2(3) inserts references to value added tax ('VAT') returns and VAT payment obligations into Column 1 of Table 3 in regulation 32 of the 2005 Regulations to extend the current exceptions from compliance obligations to include (i) the submission of VAT returns and (ii) the payment of VAT within prescribed time limits.

3.4 The proposed amendments maintain consistency with the disregards that currently apply for CIS contractor monthly returns, CIS deductions under section 61 of the Finance Act 2004 and PAYE deductions.

3.5 While we welcome the proposals to exclude minor VAT non-compliance issues from being taken into account in the GPS compliance test, we do think that they may be of limited application and would suggest a post-implementation review to assess how effective the exceptions from compliance obligations contained in Regulation 32 have been in assisting sub-contractors with retaining or obtaining GPS where they have or have had minor compliance failures.

3.6 ***Exemption for landlord to tenant payments***

3.7 Draft regulation 2(1) revokes regulation 20 (reverse premiums) of the 2005 Regulations and draft regulation 2(2) inserts new regulation 24ZA (payments made by landlord to tenant) into the 2005 Regulations to exempt certain payments made by a landlord to a tenant from the definition of a 'contract payment' in section 60 of the Finance Act 2004.

3.8 We welcome the proposals to remove payments from a landlord to a tenant, where the tenant engages a subcontractor to complete construction work on the property occupied by the tenant, from the scope of the CIS.

3.9 *Regulation 20*

We understand that regulation 20 (reverse premiums) is being withdrawn because HMRC considers that new regulation 24ZA covers all instances of payments between landlord and tenant and therefore regulation 20 is no longer required.

3.10 Regulation 20 covers reverse premiums. In the context of landlord contributions, this would refer to 'Category B' contributions whereby a landlord makes a contribution towards tenant works. While a reverse premium would be either a payment for construction operations, in which case new regulation 24ZA should apply, or not for construction operations, in which case the CIS would not apply to the payment, we are aware that some have queried whether incentives and tenant works is within scope of the new exemption. We therefore suggest that guidance includes reference to reverse premiums in the context of tenant incentives as being outside the scope of CIS, for example, because a Category B payment arises only because the landlord wants to incentivise the tenant to take on the lease and, therefore, the payment arises 'as a consequence of the lease agreement'.

3.11 *Regulation 24ZA*

Regulation 24ZA(3)(b) defines a landlord by reference to an entitlement to receive rent under the lease agreement that is the basis for the carrying out of the works. However, it is not clear to us what this is seeking to achieve, and we think it would be helpful if HMRC could explain what the definition is intended to include/exclude. A 'landlord' is a property law concept. Therefore (i) the proposed definition would not include a superior landlord, and (ii) there are situations in which the landlord is not entitled to rent (or possibly only receives a peppercorn rent) but may still require works to be carried out. Overall, we think it would be better not to define a landlord in the regulations and let the term have its natural meaning.

3.12 Furthermore, we believe that the omission of a definition of a 'lease agreement' could cause difficulties. The implication from the definition of 'landlord' in regulation 24ZA(3)(b) is that a 'lease agreement' is intended to be the lease under which rent is paid. However, in the majority of cases in which new leases are granted involving landlord contributions, the works are documented and carried out under the agreement for lease,

or sometimes a side letter, and not the lease itself (whereas the rent is payable under the lease, not the agreement for lease).

3.13 For reference, an agreement for lease is an agreement to enter into a legally binding contract between landlord and tenant once certain conditions are fulfilled, ie completion of building works. An agreement for lease and lease are negotiated at the same time and once both documents are agreed the agreement for lease is exchanged and then the lease is completed in accordance with the terms and conditions of the agreement for lease.

3.14 Additionally, there will also be cases in which works may be carried out as part of arrangements for a renewal/extension to or variation of a lease, or possibly as part of works being carried out under a licence for alterations – none of which are agreements under which rent is payable. These contributions and payments are legally constituted via a side letter.

3.15 We believe that regulation 24ZA(2)(a) should include the above situations.

3.16 We therefore suggest defining a lease agreement as an addition to regulation 24ZA(3) such that it would include the lease, an agreement for lease, an agreement for variation or extension of a lease or a licence for alterations. It would also be helpful for the sake of clarity if references to lease included a tenancy at will or licence to occupy. Alternatively, we suggest as a minimum amending regulation 24ZA(2)(a) to state:

> 'the payment is for construction operations agreed in consequence of the lease <u>or any document connected with the lease</u>'.

3.17 Regulation 24ZA(2)(b) requires there to be a 'written contract' between the tenant and the person undertaking the construction operations. However, it seems to us that it is unreasonable for a landlord to have to confirm a written agreement is in place between tenant and person undertaking the works. First, there is the issue of confidentiality, there may be sensitive information or restrictions on sharing the contract with third parties. Additionally, often for smaller works, there is no written contract. While we understand this is intended as an anti-avoidance measure to ensure that the tenant is not the contractor for the works being paid for but pays someone else, we do not believe there needs to be a written contract or that the landlord needs to see this.

3.18 We would suggest confirming that (i) the landlord does not actually need to see this contract and that a warranty given by the tenant to the landlord that the contract exists would be sufficient, and (ii) where there is no written contract, and to the extent evidence of works may be required, alternative evidence such as copies of invoice payments to their contractor will suffice (albeit this may still be quite onerous if there are substantial invoices for major Category A fit-out works).

3.19 Regulation 24ZA(2)(c) requires the construction obligations to relate exclusively to parts of the property that the tenant occupies or will occupy under the lease agreement. As such it does not take into account common areas in a building.

3.20 Firstly, as explained at paragraphs 3.12-3.16 above, the requirement in regulation 24ZA(2)(c) that '*the tenant occupies or will occupy under the <u>lease agreement</u>*' (emphasis added) will cause difficulties. For example, where the tenant occupies the property under a different agreement to that under which the works are to be carried out, unless a definition of a lease agreement as suggested above is added.

3.21 Additionally, there will be cases in which the works carried out by the tenant may, for practical reasons, extend beyond the demise of the tenant's premises, for example into common areas. For example, a financial

institution may require security on entrances and exits to be improved in order to comply with their regulatory obligations, or the tenant may require additional power capacity for its data centre but this additional 'kit' would be located in the common areas with the existing kit servicing the whole building.

3.22 We therefore consider that it would be helpful if this exclusivity requirement were relaxed to include works substantially within the tenant's demise. In our view the concept for the works should be that the construction operations benefit the parts of the property that the tenant occupies. We therefore suggest amending regulation 24ZA(2)(c) to read along the lines of:

> 'the payment is for construction operations relating to works exclusively used by the tenant, or substantially benefitting the tenant, in connection with the property the tenant occupies or will occupy'.

3.23 We would also suggest clarifying in guidance that works such as installing floor boxes fall within scope of regulation 24ZA(2)(c). As the name suggests, they are below the floor, so it is not obvious that the tenant 'occupies' that area.

3.24 We welcome the clarification in regulation 24ZA(3)(a) that a tenant includes a sub-tenant, as there may be circumstances under which a landlord assists in contributions being made to a sub-tenant rather than to the direct tenant. Similarly, any reference to landlord (however, that is defined), should make it clear that it relates to a superior landlord as well as the direct landlord.

3.25 ***Commencement provisions***

These regulations are expected to come into force from 6 April 2024. We think it would be helpful if it is made clear that new regulation 24ZA is to be applied to CIS payments based on the date of payment rather than the date the respective agreement for lease/lease is entered into.

3.26 ***Exclusion of payments from tenants to landlords***

The proposed new regulation excludes payments from tenants to landlords where the landlord agrees to engage a subcontractor to complete construction work on the property occupied or to be occupied by the tenant. While we do not view this as a major issue, we think it would be helpful to have a 'small works' exemption. For example, the landlord (or their agent) may arrange for minor works to be done for a tenant during their lease term. It would be administratively easier to take these small payments out of scope of the CIS.

3.27 ***Gendered language***

We were disappointed to note that gendered language is being used in regulation 24ZA(3)(b): '*reference to 'landlord' include any person who, under a lease agreement is, as between* ***himself*** *and the tenant, for the time being entitled to the rent payable under that agreement*' (emphasis added). If the definition of a landlord is retained (see above) we suggest amending the definition to be gender neutral.

4 Acknowledgement of submission

4.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

8 January 2024