

ACTIVE PRACTICE UPDATES

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McCleary & Company Ltd.

Chartered Accountants & Registered Auditors

CONSTRUCTION INDUSTRY SCHEME

Delving into recent changes that affect the CIS.

The construction industry remains one of the UK's key sectors, which also helps to underpin the UK economy, despite experiencing the effects of the COVID-19 pandemic.

In September 2021, construction output grew by 1.3% on the previous month – placing the sector just 1% below its pre-pandemic level – and worth a decent share of UK GDP.

Despite this monthly fluctuation, the Government remains committed to delivering up to 300,000 new homes a year by the mid-2020s.

Major infrastructure projects like the HS2 railway line and Hinkley Point nuclear power station in Somerset are also edging closer to completion.

It's easy to see how the construction sector employs "more than 9% of the UK's total workforce", roughly equating to around 3.1 million people.

Many of these will be familiar with the complexities of the construction industry scheme (CIS), which sets out rules for how payments to subcontractors for construction work must be handled by contractors in the industry, taking into account the subcontractor's tax status.

From a tax perspective, there have been recent changes announced in the last 12 months which affect both the CIS and UK VAT. Not that many would know, given the lack of publicity.

WHO DOES THE CIS AFFECT?

Under the CIS, all payments made from contractors to subcontractors must take account of the subcontractor's tax status as determined by HMRC.

This may require the contractor to make a deduction, which they then pay to HMRC, from that part of the payment that does not represent the cost of materials incurred by the subcontractor.

The CIS covers all construction work carried out in the UK, including site preparation, alterations, dismantling, construction, repairs, decorating, and demolition.

Any type of domestic or overseas construction business – companies, partnerships, and sole traders – working in the UK must register for the CIS, regardless of whether they're a contractor or subcontractor.

CONTRACTORS & SUBCONTRACTORS

'Contractors' and 'subcontractors' have special meanings that cover more than is generally referred to as 'construction'.

A **contractor** is a business or other concern that pays subcontractors for construction work. They might be construction companies or building firms, but may also be government departments, local authorities and many other businesses that are normally known in the industry as 'clients'.

If a business or other concern spends more than £3 million on construction within the previous 12 months, they will be treated as a 'deemed contractor' and must monitor their construction spend regularly. Conversely, a **subcontractor** is simply a business that carries out construction work for a contractor.

In some cases, it's possible for a business to be both **contractor and subcontractor**. This occurs when a business pays another firm for construction work, but also receives payment from another business.

When they're working as a contractor, they must follow the CIS rules for contractors and when they're working as a subcontractor, they must follow the rules for subcontractors.

HOW THE CIS WORKS

All contractors and subcontractors should register with HMRC for the CIS. Subcontractors will be subject to a higher-rate deduction if they have not registered.

Contractors deduct money from a subcontractor's payments and pass it to HMRC. These deductions count as advance payments towards income tax and National Insurance, similar to PAYE.

A limited company will have deductions taken by the contractor from the income due to the company.

This deduction can then be offset against other company tax liabilities such as PAYE, VAT, corporation tax or can be refunded to the company after the end of the tax year.

Sole traders and partnerships will also have deductions made from the income they receive.

They are then required to report their gross income on their self-assessment tax returns, with contractor deductions also reported on the tax return and subsequently deducted from any income tax liability which is calculated as being due.

Contractors need to verify a subcontractor's status with HMRC before payment is made to establish whether they are registered and the correct amount of tax to withhold. Tax can be deducted at source at 0%, 20% or 30%.

Contractors must report all of the payments they have made under the CIS to the tax authority, or report they have made no payments in the tax month, by the 19th of each month.

Penalties apply if the monthly return deadline is missed.

RECENT CHANGES TO THE CIS

Four new measures affecting the CIS came in for 2021/22, which aim to crack down on tackling labour fraud. An obvious example is where a contractor pays casual workers cash-in-hand.

First, HMRC can **amend the CIS deductions** suffered and reclaimed on real-time information via the employment payment summary to an amount matching any evidence it holds.

If there is no evidence, or a construction firm is not entitled to set-off in this way, HMRC can remove the claim and prevent you from submitting another set-off claim for the rest of a tax year.

Being on the wrong side of this change could cause significant cashflow disruption and detailed records should be kept to support any set-off claims.

The second change is aimed at subcontractors who claim the **cost of materials** on a project, and avoid a CIS deduction on this amount as a result.

It is only where a subcontractor directly incurs the cost of materials bought to fulfil a particular building contract that the cost in question is not subject to a CIS deduction.

Under CIS rules, contractors must ascertain both how much was spent and that it represents the direct cost to that subcontractor for the contract.

The third change updates the rules for operating CIS as a **deemed contractor**.

Businesses operating outside the construction sector need to apply the CIS when their total spending on construction operations exceeds £3 million over the past 12 rolling months.

Previously, a business only had to operate under the CIS if its average expenditure on construction operations exceeded £1m over the last three tax years.

Last but not least, HMRC has expanded the scope for **imposing a penalty** for supplying false information on payment applications under deduction or gross payment status.

The person or business to whom the registration applied could be penalised before last month, but now this also applies to anyone who exercises influence or control over a person registering for the CIS and either encourages that person to make a false statement or does so themselves.

THE EFFECTS OF REVERSE CHARGE VAT

The VAT domestic reverse charge for building and construction services finally took effect on 1 March 2021.

It affects VAT-registered businesses, typically those who either take on contracts or subcontract others within a supply chain, that operate under the CIS.

Companies in the construction supply chain no longer receive their 20% VAT payment when they submit bills. Instead, the VAT is paid directly to HMRC by the 'customer' receiving the service.

The change is causing cashflow shortages for VAT-registered contractors, some of whom are owed repayments from HMRC at the end of each quarter dating as far back as last spring.

The tax authority said verification checks are slowing up the process, with some cases taking 30 days or longer while it waits for customers to supply the information required to verify the VAT return.

We can advise on the CIS.