

The New Construction Industry Scheme

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The new Construction Industry Scheme (CIS) rules take effect as from 6 April 2007. The new rules were first outlined in the 2004 Finance Act and these were expanded upon in SI 2005/2045.

The old CIS was a system involving:

- Gross payment certificates and registration cards;
- Vouchers issued by contractors to subcontractors showing the payments made and tax deducted; and
- End-of year-returns.

From 6 April 2007, this will be replaced by the new CIS, which involves:

- Registration by subcontractors;
- Verification by contractors to confirm whether subcontractors should be paid net or gross;
- Payment statements; and
- Monthly returns CIS300, requiring a declaration that the contractor has considered the employment status of each subcontractor to ensure that subcontractors operating as employees are not claiming self-employed status.

The purpose of this session is to give an overview of the new CIS. It will cover the following sub-topics:

- Who the Scheme applies to
- Registration by subcontractors
- The criteria subcontractors need to meet for approval from HMRC to be paid gross
- Verification by the contractor
- Payment and 'payment statements'
- Monthly returns
- Is the subcontractor employed or self-employed?

- Record keeping
- Other penalties

Who the Scheme Applies To

The Scheme applies to payments made by ‘contractors’ to ‘subcontractors’ for work involving construction and also other types of work including repairs, installation, cleaning, painting or decorating and demolition. A list of ‘construction operations’ is given in s74 FA 2004, which also includes a list of operations that are outside the Scheme. HMRC provides guidance in its factsheet CIS348 on which types of construction work are within the Scheme and which are not, as follows (HMRC emphasises that this list is not exhaustive):

<p><u>Planning</u></p> <p>Operations included</p> <p>None</p>	<p>Operations excluded</p> <p>Professional work (including the ancillary work of engineers, draughtsmen, scientists and technicians) of architects, surveyors or consultants in building, engineering, decoration (interior or exterior) or landscaping.</p>
<p><u>Site preparation</u></p> <p>Operations included</p> <p>Demolition of buildings and structures, tree-felling.</p> <p>Preparation of site and site-clearance, earth-moving on site, excavation, tunnelling and boring.</p>	<p>Operations excluded</p> <p>Delivery of materials.</p> <p>Transport of spoil from site.</p>

<p><u>Construction</u></p> <p>Operations included</p> <p>Preparation and laying of foundations and piling.</p> <p>Actual construction, alteration or repair of a permanent or temporary building or civil, chemical or other industrial engineering work or industrial plant or structure. For example</p> <ul style="list-style-type: none"> - storage tanks - silos - pylons - cranes or derricks - pumps. <p>Construction of site facilities.</p> <p>Installation of power lines, pipelines, gas mains, sewers, drainage, cable television and telecommunications, distribution</p>	<p>Operations excluded</p> <p>Manufacture or off-site fabrication of components or equipment, materials, plant or machinery and delivery of these to the site. For example</p> <ul style="list-style-type: none"> - traditional building materials - prefabricated beams and panels - ready-mixed concrete. <p>Manufacture and delivery of pre-fabricated site facilities.</p> <p>Running of site facilities such as canteens, hostels, offices, toilets and medical centres or the supply of security guards.</p> <p>Installation or replacement of telecommunication or computer wiring through pre-existing ducting in buildings.</p>

systems.	
<p><u>Construction (continued)</u></p> <p>Operations included</p> <p>Installation of closed circuit television for purposes other than security (such as traffic management).</p> <p>Installation of public services.</p> <p>Construction, repair and resurfacing of roads and bridges, including white-lining.</p> <p>Provision of temporary and permanent roadways and other access works such as drives.</p> <p>Erection or dismantling of scaffolding falsework and formwork.</p> <p>Plant hire with operator for use on site.</p> <p>Installation of fire protection systems designed specifically to protect the fabric of the building (such as sprinkler systems, fireproof cladding) rather than a fire warning (alarm) system.</p> <p>Installation of pre-fabricated components or equipment under 'supply and fix' arrangements.</p>	<p>Operations excluded</p> <p>Delivery of road-making materials.</p> <p>Hire of scaffolding equipment (without labour).</p> <p>Delivery, repair or maintenance of construction plant or hire equipment without an operator. For example, concrete mixers, pumps and skips.</p> <p>Installation of fire alarms, security systems including burglar alarms, closed-circuit television as part of a security system, and public address systems.</p>

Construction (continued)

Operations included

Transport of materials on site.

Internal cleaning of buildings and structures carried out in the course of or on completion of, their construction, alteration, extension, repair or restoration.

Work done on installations (such as rigs, pipelines, construction platforms) maintained or intended to be established for underwater exploration for, or exploitation of, minerals where the work is on land or in UK territorial waters (up to the 12-mile limit).

Installation of systems of heating, lighting, air conditioning, ventilation, power supply and distribution, drainage, sanitation, water supply and distribution, and fire protection works.

Installation of lifts, plant or machinery needed by the specification of a building under construction or alteration.

Operations excluded

Transport of materials from site to site on the public highway.

Assembly of temporary stages and exhibition stands, including lighting.

External cleaning (other than painting or decorating) of buildings and structures.

Drilling for, or extraction of, oil or natural gas.

Extraction of minerals, boring or construction of underground works for this purpose.

Manufacture, delivery, repair or maintenance of these items.

Servicing, repair or maintenance of these items.

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<p><u>Construction (continued)</u></p> <p>Operations included</p> <p>Construction and repair of industrial plant.</p> <p>Site restoration and landscaping.</p> <p>Installation, structural repair and painting of lamp standards, traffic lights, parking meters and street furniture.</p> <p>Construction of concrete and marble floors.</p> <p>Fitting of eye bolts, whether internal or external.</p> <p>Installation of and repair to</p> <ul style="list-style-type: none"> - glazing - doors and rolling grills or security shutters - kitchens and bathrooms - shop-fittings including fixed furniture (except seating). <p>Painting and decorating the internal or external surfaces of any building or structure.</p>	<p>Operations excluded</p> <p>Tree planting and felling in the ordinary course of forestry or estate management.</p> <p>Manufacture and delivery of lamp standards. Routine maintenance such as cleaning and general replacement.</p> <p>Manufacture off-site and delivery of flooring materials.</p> <p>Manufacture and delivery of:</p> <ul style="list-style-type: none"> - glazing materials - computer and instrumentation systems - thermal insulation materials - heating and ventilation systems - doors and rolling grills - painting or decorating materials. <p>Manufacture, delivery and installation of</p>
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A 'subcontractor' is any business which has agreed to carry out construction operations for another business (the 'contractor'). The term 'contractor' is defined in s59 FA 2004 and includes:

- Any person carrying on a business that undertakes construction operations;
- Any public office or department of the Crown (including any Northern Ireland department and any part of the Scottish Administration);
- Local authorities;
- The Corporate Officer of the House of Lords, the Corporate Officer of the House of Commons and the Scottish Parliamentary Corporate body;
- Any development corporation or new town commission;
- The Commission for the New Towns;
- The Secretary of State if the contract is made by him under s89 of the Housing Associations Act 1985;
- The Housing Corporation, a housing association, a housing trust, Scottish Homes and the Northern Ireland Housing Executive;
- Any NHS trust;
- Any HSS trust;
- Any other body that has been designated by the Board of HMRC which has been established for the purpose of carrying out statutory functions.

Any business which spends on average over £1 million per year over a period of three years ending on its last period of account is also classed as a 'contractor'. Where the business did not exist at the beginning of that three year period, the business is a 'deemed contractor' if one third of its total expenditure on construction operations since carrying on the business exceeds £1 million.

Registration by Subcontractors

If a subcontractor starts working in the construction industry on or after 6 April 2007 or had a temporary registration card that has expired, it will need to register for the new CIS. To register, subcontractors can either call the HMRC CIS Helpline or visit the HMRC website.

When new subcontractors register with HMRC, they can apply to be paid gross (if they meet certain criteria), otherwise they will have tax deducted at 20%. In calculating the amount of tax to deduct, the following should be deducted from the payments:

- VAT charged by the subcontractor if it is registered for VAT.
- The cost of materials, consumable stores, fuel (except fuel for travelling), plant hire and the cost of manufacture or prefabrication of materials.
- The VAT paid on the items above if the subcontractor is registered for VAT.

Appendix D of HMRC's guide CIS340 gives examples of how to calculate the deduction required from payments made to subcontractors (although HMRC applies a rate of 18%, which should be 20%). Below are two of the examples given.

A tiling subcontractor, who is not VAT-registered, agrees to tile a wall and to supply the necessary materials for a total payment of £535. The materials cost the subcontractor a total of £235 (£200 + £35 for VAT).

	£
Labour charge	300
Materials	<u>235</u>
Amount due (invoice amount)	<u>535</u>
Calculation of deduction	
Total payment	535
Less cost of materials (inclusive of VAT)	-235
Amount liable to deduction	300
Amount deducted at 20%	<u>-60</u>
Net payment to subcontractor	<u>475</u>

The contractor deducts the cost of materials from the price for the whole job and calculates the deduction on the difference of £300. The contractor has to pay £60 to our Accounts Office and pays £475 (£535 - £60) to the subcontractor.

Entries on the contractor's monthly return

In this example, the contractor should enter the following amounts in the appropriate boxes on the contractor's monthly return:

Total payment	535
Direct cost of materials used	235
Amount deducted	60

For a total cost of £600, a subcontractor who is a taxable person for VAT purposes, agrees to paint the interior of a building and to supply the materials. The painter pays £235 for the materials, which includes VAT of £35.

	£
Labour charge	400
Materials	200
Gross payment	600
Add VAT	<u>105</u>
Amount due (invoice amount)	<u>705</u>

Calculation of deduction

Total payment (exclusive of VAT)	600
Less cost of materials (exclusive of VAT)	-200
Amount liable to deduction	400
Amount deducted at 20%	<u>-80</u>
Net payment to subcontractor	<u>625</u>

The subcontractor is paid £625, which is the invoice amount (£705) less the deduction (£80).

Entries on the contractor's monthly return

In this example, the contractor should enter the following amounts in the appropriate boxes on the contractor's monthly return:

Total payment	600
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Direct cost of materials used	200
Amount deducted	80

Subcontractors that were registered under the 'old-CIS' (pre-6 April 2007) do not need to register for the new scheme, provided they do not hold a temporary registration card that expired pre-April 2007.

If the subcontractor is not registered with HMRC, the contractor must deduct 30% tax from any payments made to them.

The Criteria Subcontractors Need to Meet For Approval From HMRC to be Paid Gross

In order to obtain HMRC approval to be paid gross, subcontractors need to pass three tests:

- The business test;
- The turnover test; and
- The compliance test.

These tests are outlined in s64 FA 2004, Sch 11 FA 2004 and Part 6 SI 2005/2045.

The Business Test

The subcontractor must carry out construction work in the UK, or provide labour for such work, and the business must be run through a UK bank account.

The Turnover Test

The test is based on the subcontractor's net turnover, i.e. its gross income from construction work ignoring VAT and the cost of materials. There are two turnover tests: the standard test and the alternative test. The test(s) to be applied depends on whether the business is a sole trade, partnership or company.

Sole trade

Only the standard test is available – net construction turnover must be at least £30,000 in the 12 months before making the application for gross payment.

Partnerships

Both the standard test and alternative test are available. Only one needs to be passed.

Standard test: Net construction turnover must be at least £30,000 for each partner in the 12 months before making the application for gross payment; or

Alternative test: Net construction turnover of the partnership must be at least £200,000 in the same period.

Companies

No test needs to be passed by companies which are wholly owned by companies that have already received approval to be paid gross. Otherwise the standard test or alternative test needs to be passed as follows:

Standard test: Net construction turnover must be at least £30,000 for each director and, in the case of a close company, for each shareholder in the 12 months before making the application for gross payment; or

Alternative test: Net construction turnover of the company must be at least £200,000 in the same period.

The Compliance Test

In the 12 months up to the date of application (down from three years under the old CIS), the sole trader, all partners in the case of a partnership, or all directors in the case of a company need to have:

- Completed and submitted all tax returns (including employers' end of year returns P35, and corporation tax accounts and computations, where appropriate);

- Paid all tax by the due dates (including PAYE, NIC, CIS and corporation tax, where applicable); and
- Provided any information requested by HMRC.

HMRC has stated in its factsheet CIS343 that it will disregard certain minor infringements when reviewing the business' compliance record during the 12 months up to the date of application, as follows:

- 'Three late submissions of the monthly return – up to 28 days late.
- Three late payments of CIS/PAYE deductions – up to 14 days late.
- One late payment of self-assessment tax – up to 28 days late.
- Any employer's end-of-year return made late.
- Any late payments of corporation tax – up to 28 days late, including where any shortfall in the payment has incurred an interest charge but no penalty.
- Any self-assessment return made late.
- Any failures classed as 'minor and technical' in relation to [the subcontractor's] obligations under the old Scheme, where these fall within the 12-month period up to [their] application.'

Verification by the Contractor

Contractors need to verify the subcontractors that work for them to see if they are registered for CIS and, if so, establish whether they should pay the subcontractor gross or with tax deducted at 20%. If the subcontractor is not registered, tax must be deducted from payments to subcontractors at a rate of 30%.

Contractors do not, however, need to verify subcontractors if they have paid them in the current or previous two tax years and when they last paid them they saw either the subcontractor's tax certificate (with an expiry date of 6 April 2007 or later), registration card (with an expiry date of 6 April 2007 or later), or they have already included them on any monthly return in the current tax year.

HMRC sent a list of subcontractors used since April 2005 to each contractor in November 2006 and have done/will do so again in March 2007. The subcontractors listed do not need to be verified. If the contractor's list has more than 125 subcontractors, this is provided by CD-ROM.

If a subcontractor has already been included on a return of one of the other companies in the group within the current tax year or the previous two tax years, no further verification is required.

If a contractor does need to verify a subcontractor, this needs to be done after the contract has been agreed with them or after they have formally accepted a tender for work under a contract.

In order to verify the subcontractor, the contractor will need to phone HMRC, visit HMRC's website, or use electronic data interchange (EDI), or use other third party software.

The contractor will need to provide HMRC with its details, as follows:

- Its name;
- Its UTR;
- Its accounts office reference; and
- Its employer reference.

The information that the contractor needs to provide HMRC in respect of the subcontractor depends on whether the subcontractor is a sole trader, partnership or company. The table below shows what needs to be provided in each instance:

Sole trader	Partnership	Company
<ul style="list-style-type: none"> • Name • UTR • NI number 	<ul style="list-style-type: none"> • Name of firm • Partner's name • Firm's UTR 	<ul style="list-style-type: none"> • Company name • Company UTR • Company registration number

	<p>If the partner is an individual</p> <ul style="list-style-type: none"> • Partner's UTR or NI number <p>If the partner is a company</p> <ul style="list-style-type: none"> • Company's UTR or company registration number 	
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The contractor will therefore need to request the above information from any new subcontractor.

Payment and 'Payment Statements'

When a contractor verifies a subcontractor, HMRC will let the contractor know whether to make payments to the subcontractor gross, with tax deducted of 20% or with tax deducted of 30% (the default if the subcontractor is not registered, or the details provided to HMRC do not 'match' its records). HMRC will provide a ten digit verification number, which will be the same number for all subcontractors verified at the same time. The verification number for 'unmatched' subcontractors will end with '/' plus one or two letters. The verification number needs to be reported on the monthly return.

If the contractor does not need to verify the subcontractor, it should continue to pay the subcontractor as before, unless otherwise instructed by HMRC. If tax was deducted under the old Scheme, from 6 April 2007, tax must be deducted at 20% rather than 18%.

The contractor will need to send HMRC all deductions that it made in the tax month by the 19th of the month following the end of the tax month in which the payments are made. If payment is made electronically, the deadline is the 22nd of the month.

The contractor can choose to account for the deductions quarterly where its average monthly payments for the current tax year are below £1,500 (taking into account any PAYE tax and NICs deductions from employees' pay). The tax quarters end on 5 July, 5 October, 5 January and 5 April.

Where a contractor pays a subcontractor with tax deducted, it must give the subcontractor a 'payment statement' by the 19th of the month following the tax month in which the payment is made. Alternatively, a statement can be provided to the subcontractor with each payment. This statement can be produced in any format, but must be in writing or faxed, or provided electronically (if the subcontractor agrees to this). Payment statements need not be provided to subcontractors paid gross.

The following details need to be included in the payment statement:

- The contractor's name;
- The contractor's employer's reference;
- The tax year and month the payment(s) were made;
- The subcontractor's name and UTR;
- Details of the total payment(s) made;
- The cost of any materials paid for; and
- Details of the deductions made.

When the contractor pays the deductions over to HMRC, they are held on account of the subcontractor's income tax and Class 4 NICs payable for the tax year. Any excess paid or additional liability will be repaid/payable via the self-assessment return process.

If the subcontractor is a sole trader or partnership and its accounting period ends early in the tax year, for example 31 December, it may apply for an in-year repayment where it believes the income tax and Class 4 NICs already deducted from its payments exceed its liability for the year. The subcontractor can request an application form from the CIS Helpline. There are different forms depending on whether the subcontractor is a sole trader or partnership.

If the subcontractor is a company, there is no in-year repayment option, but there are separate rules which enable the subcontractor to set any deductions that it has suffered against any PAYE, NIC and CIS deductions that it needs to make.

Monthly Returns

From 6 April 2007, contractors must send a monthly return (CIS300) to HMRC. HMRC will send contractors a return CIS300 towards the end of each tax month, unless the contractor would prefer to use appropriate third-party software, EDI or the Internet. HMRC will pre-populate the return with the information it holds about the contractor's business and the subcontractors that have been verified or recently included in one of the contractor's returns.

Contractors will need to firstly check the information already included in the return and add any new subcontractors that are not already shown. They then need to add the following information on the return:

- Details of all the payments made to all subcontractors under CIS;
- Details of the deductions made from payments to subcontractors;
- A declaration confirming that the employment status of each subcontractor has been considered; and
- A declaration that the verification process has been completed correctly.

The total tax deducted under the CIS should be included in the form P35 (employer's return) at the end of the tax year.

The return needs to be submitted to HMRC by the 19th of the month following the end of the tax month to which it relates. The return can be submitted:

- Via the HMRC website;
- Electronically, using appropriate third-party software;
- By EDI; or
- By post to Construction Industry Scheme, Bootle, L69 9ZX.

A nil return would still need to be made if the contractor has not paid any subcontractors. This can be made by phoning HMRC. If a contractor does not plan

to make any payments to subcontractors for a while, it can request that HMRC stops sending returns for a period of up to six months.

The return must reflect the actual payments and deductions made in the tax month, rather than what should have been paid/deducted. If an error is made, if possible, this should be corrected in the return for the following month. However, if this is not possible, for example if the subcontractor leaves, corrections can be made by phoning HMRC, which will correct the subcontractor's record. The contractor must keep a record of the changes made.

If the return is submitted late (even if this is a nil return), a £100 penalty will be imposed by HMRC. If the return shows more than 50 subcontractors, the penalty will be increased by £100 for every additional 50 subcontractors. For example:

Number of subcontractors on return	Amount of penalty
10	£100
55	£200
110	£300
620	£1,300

The same penalty will be charged for each month that the return is late.

Is the Subcontractor Employed or Self-Employed?

It is the contractor's responsibility to get the status of the employment status of each contractor right. There is no definition of employment or self-employment in the tax legislation and so it is necessary to look at the facts of each case.

HMRC provides guidance on this subject in its factsheet CIS349, as follows:

Common indicators of employment

- The contractor has the right to control what the worker has to do – where, when and how it is done – even if the contractor rarely uses that control.
- The worker supplies only his or her own small tools.
- The worker does not risk his or her own money and there is no possibility that he or she will suffer a financial loss.
- The worker has no business organisation, for example, a yard, stock, materials, or workers. (These examples are not exhaustive.)
- The worker is paid by the hour, day, week or month.

Common indicators of self-employment

- Within an overall deadline, the worker has the right to decide how and when the work will be done.
- The worker supplies the materials, plant or heavy equipment needed for the job.
- The worker bids for a job and will bear the additional cost if the job ends up costing more than the worker's original estimate.
- The worker has a right to hire other people who answer to him or her and are paid by him or her to do the job.
- The worker is paid an agreed amount for the job regardless of how long it takes.
- To make a decision on an individual case, you will need to consider all the details, and the overall situation.

Record Keeping

Contractors and subcontractors need to keep records for a period of three years from the end of the tax year to which they relate, in case HMRC decide to enquire into their affairs. These records do not need to be kept in paper format. A penalty of up to £3,000 may be imposed by HMRC for non-compliance.

Other Penalties

As well as the penalties that may be imposed for monthly returns submitted late, a penalty of £3,000 may be incurred if the return is incomplete or incorrect, where the omission/error was caused by negligence or intent.

Penalties may also be incurred for the following:

- Failure, when required, to produce records relating to payments made under the Scheme.
- Failure to provide subcontractors under deduction with a statement for each payment or for each month.

Furthermore, where a subcontractor has been treated as working on a self-employed basis by a business, but in reality is operating as an employee, the PAYE/NICs that should have been deducted will be payable. HMRC may pursue liabilities dating back six years, if appropriate, and charge interest and penalties.