

The construction industry

The construction industry scheme

There are special tax rules affecting the construction industry, which are designed to ensure that tax is paid by workers who are self-employed. Employees must be paid under PAYE, and are not within the construction industry scheme.

The construction industry scheme places obligations on contractors - those who engage labour for construction work - and failure to operate the scheme correctly carries very significant financial penalties.

Construction contract

Tax must be deducted at source from a payment under a construction contract, which is a contract between a contractor and a subcontractor for construction services unless the subcontractor has registered with HMRC for being paid gross.

The definition of construction services for this purpose is very wide and includes not only obvious building work but also, for example, the cleaning of newly constructed premises before the occupiers move in, and landscaping associated with building projects.

There is [detailed guidance from HMRC](#) to help you decide whether you are carrying on construction operations or not.

Contractors

For the purposes of the construction industry tax scheme, the contractor is the person who makes payments to subcontractors for construction work.

Contractors are required to register under the scheme and to operate the scheme on any payments made and to make monthly returns of payments made under the scheme.

It is possible to be both a contractor and a subcontractor, where 'engaged' within a 'chain' of businesses on a construction project.

In this case it is necessary to make deductions from payments made even if deductions may be suffered on payments received.

The arrangements for offsetting these tax deductions against each other depends on whether the business is a limited company or not.

Subcontractors

Subcontractors are engaged to provide labour on a construction project. It is not possible to be a subcontractor in a 'materials only' supply.

In this case it is necessary to register under the scheme and, subject to meeting certain criteria, the business may qualify to be paid without deductions.

Contractors - what you must do

Register as a contractor

The first step is to register for the scheme. This is necessary before anyone is paid under the scheme. If the business already has a payroll for employees, the registration process will require the payroll reference.

Once registered returns are required on a monthly basis (more details of this follow). The penalty for late registration can run into thousands of pounds as the contractor will be fined for each late monthly return, although the total penalty is subject to a limit of £3,000.

Employment status

When someone is engaged to provide labour on a construction project, checks must be carried out to establish their employment status. This does not apply if the subcontractor is a limited company, but otherwise guidance should be sought from HMRC to help you decide.

The construction industry scheme deductions and reporting requirements only relate to subcontractors. Employees will be placed on the payroll and have PAYE and NICs deducted. There is more detail on this often difficult area in employed or self-employed?

Verification

Once the person's employment status is determined, it is necessary to establish whether tax should be deducted from payments and what rate. This requires basic details from the subcontractor, including the name of the individual or business through which the trade is conducted, the unique taxpayer reference (UTR) number applying to the business and the national insurance number for individuals or company registration number of a limited company.

When a subcontractor is engaged for the first time, it is necessary to contact HMRC to verify the tax status of subcontractor. This must be done online. You will need to ascertain whether the subcontractor is registered for gross or net payments. Some subcontractors will be 'unmatched' as a response which can mean either that the identity information may be incorrect, or that the person is not registered under the scheme. Verification responses include a verification number, which should be retained.

Once verified, payments to the subcontractor can continue without further verification so long as a payment was made in the current or two previous tax years. HMRC will advise, in writing, if the registered tax status of any of the subcontractors changes otherwise the same tax treatment should continue to apply.

Paying subcontractors

When a subcontractor is registered for gross payment there is no need to make any deductions from payments; but payments must not be made to anyone else, such as a nominee at the request of the subcontractor without first checking the nominee's CIS status.

Where a subcontractor is registered for net payment CIS tax at a rate of 20% should be deducted from the full amount of the payment made less a deduction for the cost of materials. Tax must be deducted from any profit element on materials, and also from allowances for travel. However, if the subcontractor is registered for VAT, no deduction is made from the VAT element of invoices.

Where a subcontractor is unmatched, tax at 30% will apply to the payment in respect of the supply of labour. However, it is worth checking the details used, as it may be that an error was made when asking for verification. If a 30% deduction applies, then the verification number will need to be recorded against each payment and provided to HMRC and the subcontractor with details of the payment.

Contractors must issue a payment statement to each subcontractor who has suffered tax on payments. The statement may cover all payments in a tax month, or each individual payment. Although there is no prescribed format, payment statements must include certain information, and HMRC provide a suitable format on the internet at www.hmrc.gov.uk. There is a penalty for failure to issue payment statements to subcontractors.

Returns

Each tax month, contractors are required to make an online return of all payments to subcontractors, including those that did not suffer tax on payments.

The return must be made online, and must be filed within 14 days of the end of the tax month - that is by 19th of each month. Nil returns are no longer required when no payments have been made.

The penalty for late returns is a minimum of £100 and this is charged when the return is one day late, and a further penalty when it is 2 months late.

After 6 months the penalty is a percentage of the tax on the return, subject to a minimum of £300. Note that the penalties will apply even if no subcontractors have been paid in the period (a nil return).

The return also includes declarations by the contractor that all subcontractors needing verification have been verified, and that employment status has been considered, and that none of the subcontractors listed is an employee.

Repeated late returns can result in the loss of the gross payment status.

Contractors who do not expect to make payments under the scheme for at least six months can register as inactive, but will be fined if they forget to notify HMRC if this situation changes before the six months expires.

Compliance issues

Contractors who also work as subcontractors should be aware that compliance failures as contractors can affect their status as subcontractors, and may lead to losing gross payment status.

Subcontractors - what you must do

Registration

It is not necessary to register under the Construction Industry Scheme (CIS) if work is only undertaken directly for private customers, as they are not liable to operate the scheme. Otherwise, the consequence of not registering under the scheme is that 30% tax will be deducted from any payments received in respect of the supply of labour. In order to receive payment without deduction of tax it will be necessary to satisfy a number of additional tests.

Registration can be initiated by contacting HMRC. You can telephone the HMRC CIS helpline on their general enquiries number which is 0300 200 3210, which is available 7 days a week.

You will need to provide your national insurance number to obtain registration. If you do not have a national insurance number you will need to visit a tax office in person with proof of identity.

Registration for gross payment

Established businesses in the construction sector can apply to register for gross payment. Once registered, payments will be made without deduction of 20% CIS tax for the provision of labour.

In order to register for gross payment, the subcontractor needs to satisfy:

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

The business test is relatively easy to satisfy - it is necessary to demonstrate that there is an established business supplying construction services in the UK which is run largely through a bank account. The

turnover test requires that in the 12-month period before application the construction turnover (excluding cost of materials and VAT) exceeded £30,000, or £30,000 per partner or director for a partnership or limited company respectively. For a large partnership or company, the minimum turnover limit is £100,000.

The compliance test

The business and owner(s) must be up to date with all of tax obligations in order to register for gross payment - the test looks at the 12 months preceding the date of application and requires that all returns have been filed on time by the applicant(s), and that all tax due has been paid on time. Further, if asked for information by HMRC, this was provided as requested.

Once registered for gross payment, the turnover and compliance conditions are reviewed on a regular basis (at least once a year), and if a subcontractor is found to be in breach then HMRC will withdraw net payment status. Unless the subcontractor appeals against this ruling, the change of status will be notified to all contractors who have used the contractor's services in the current or two previous tax years, with the consequence that a tax deduction of 20% will be made on all future payments.

In looking at the compliance history of subcontractors, HMRC do ignore some minor breaches of the rules, so any or all of the following in the 12-month review period would be ignored:

- 3 late submissions of the CIS contractor monthly return, including 'nil' returns - up to 28 days' late
- 3 late payments of CIS/PAYE deductions - up to 14 days' late
- 1 late payment of self-assessment tax - up to 28 days' late
- Any employer's end of year return made late
- Any late payment 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 payment not made by the due date, where it is less than £100.

Keeping records

Whenever a payment is received from which tax has been deducted, the contractor has an obligation to provide a payment advice showing the details of the payment and the tax deducted. This can be provided for each payment, or otherwise on a monthly basis (for each tax month). It is important that these payment advices are retained as they include details of the tax deducted which is then available for offset against your income tax liabilities.

Limited company subcontractors can deduct the tax suffered from any payments of PAYE, NIC or CIS tax due to be made to HMRC. This is done through the RTI system, by submitting an Employer Payment Summary (EPS) by 19th of the month and deducting the CIS tax from the payment made. Otherwise the company can reclaim this tax at the end of the tax year after submitting the end of year payroll return. Any other tax owing will be withheld before a repayment is made.

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