LKA chartered accountants

A fresh approach to accounting

CONSTRUCTION INDUSTRY SCHEME

The Construction Industry Scheme (CIS) sets out special rules for tax and national insurance (NI) for those working in the construction industry.

Businesses in the construction industry are known as 'contractors' and 'subcontractors'. Under the CIS contractors deduct money from subcontractors payments and pay it to HMRC. Broadly, the purpose of these deductions is to count as advance payment of the subcontractor's tax and NI obligations.

Contractors and subcontractors

Contractors are those who pay subcontractors for construction work and include construction companies and building firms, government departments and local authorities. In addition any other business spending more than £3 million over a rolling 12 month period on construction is classed as a contractor for the purposes of the CIS.

Subcontractors are those businesses that carry out work for contractors.

Both contractors and subcontractors must register with HMRC. Many businesses act as both contractors and subcontractors and must register under both categories.

Work covered by the CIS

The CIS applies to construction work and also jobs such as site preparation, demolition, alterations, repairs, decorating and installing systems for heating, lighting, power, water and ventilation.

Certain jobs are excluded from CIS including architecture and surveying, scaffold hire (where no labour supplied), carpet fitting and delivering materials.

The same CIS rules apply if a business is based outside the UK but undertakes construction work as a contractor or subcontractor in the UK.

Contractor obligations

Monthly returns

Contractors have to make an online monthly return to HMRC:

- confirming that the employment status of subcontractors has been considered
- confirming that the verification process has been correctly dealt with
- detailing payments made to all subcontractors; and
- detailing any deductions of tax made from those payments.

The monthly return relates to each tax month (ie running from the 6th of one month to the 5th of the next). The deadline for submission is 14 days after the end of the tax month ie for the tax month 6 May to 5 June the deadline is 19 June.

Where a contractor has not made any payments to subcontractors in a tax month a return is not required but the business must tell HMRC that no return is due and when they start making payments to subcontractors again. Alternatively, a nil return could be made.

Employment status

A key part of the CIS is that the contractor has to make a monthly declaration that they have considered the status of the subcontractors and are satisfied that none of those listed on the return are employees.

Remember that employment status is not a matter of choice. The circumstances of the engagement determine how it is treated. Tests applied include the right of control, whether the subcontractor has to provide a personal service or could provide a substitute, the basis of payment and the mutuality of obligation.

LKA chartered accountants

Annecy Court, Ferry Works, Summer Road,
Thames Ditton, Surrey KT7 0QJ
Tel: 020 3915 8585

The determination of employment status is not simple and HMRC has developed software known as the employment status indicator tool, which is available on their website, to address this matter but the software appears to be heavily weighted towards re-classifying subcontractors as employees. It should not be relied on and professional advice should be taken if this is a major issue for your business. Please talk to us if you have any particular concerns in this area.

Verification

If the subcontractor is self-employed, the contractor then potentially has to contact HMRC to check whether to pay a subcontractor gross or net. This process must be completed for new subcontractors and any previously used subcontractors who have not been included on a CIS return in the current or previous two tax years.

The verification procedure will establish which of the following payment options apply:

- gross payment (no tax deduction)
- a standard rate deduction of 20% for registered subcontractors
- a higher rate deduction of 30% for unregistered subcontractors

Payments made to subcontractors

To calculate the CIS deduction, the starting point is the gross amount of the subcontractors invoice. The following amounts paid for by the subcontractor may be deducted:

- VAT
- equipment which is now unusable ('consumable stores')
- fuel used, except for travelling
- equipment hired for this job ('plant hire')
- manufacturing or prefabricating materials
- materials (only if they paid for them directly)

The relevant CIS percentage is then applied to the amount remaining after allowable deductions.

Contractors have to provide a monthly payment and deduction statement to all subcontractors paid, showing the total amount of the payments and how much tax, if any, has been deducted from those payments. This must be provided within 14 days from the end of the tax month ie the same deadline as the monthly return.

Payments to HMRC

Contractors have to pay over all deductions made from subcontractors in any given tax month by the 19th following the end of the tax month to which the deductions relate. If payment is being made electronically, the date will be the 22nd. If the contractor is a company which itself has deductions made from its payments as a subcontractor, then the deductions made may be set against the company's liabilities for PAYE, NI and any CIS deductions it is due to pay over.

Penalties

The whole system is backed up by a series of penalties. These cover situations in which an incorrect monthly return is sent in negligently or fraudulently, failure to provide CIS records for HMRC to inspect and incorrect declarations about employment status. Late returns under the CIS scheme also trigger penalties which can be up to the greater of £3,000 and 100% of the tax where the return is over 12 months late and information is withheld deliberately and concealed.

Subcontractor obligations

If a subcontractor first starts working in the construction industry they will need to register for the CIS.

Subcontractors must give contractors their name, unique taxpayer reference and national insurance number (or company registration number) when they enter into a contract. This enables the contractor to undertake verification checks above.

Gross payment status

Subcontractors can apply to HMRC to receive payments gross rather than at the standard deduction rate of 20%.

The rules for subcontractors to be paid gross include a business test, a turnover test and a compliance test. To qualify for gross payment a subcontractor must:

- have paid their tax and National Insurance on time in the past
- do construction work (or provides labour for it) in the UK
- run the business through a bank account.

The turnover for the last 12 month, ignoring VAT and the cost of materials, must be at least:

- £30,000 for a sole trader

LKA chartered accountants

Annecy Court, Ferry Works, Summer Road,
Thames Ditton, Surrey KT7 0QJ
Tel: 020 3915 8585

- £30,000 for each partner in a partnership, or at least £100,000 for the whole partnership
- £30,000 for each director of a company, or at least £100,000 for the whole company.

If the company is controlled by five people or fewer, each must have an annual turnover of £30,000.

How we can help

Please do get in touch if you would like further information about the CIS. We can advise on the CIS whether you are a contractor or a subcontractor.

For information of users: This material is published for the information of clients. It provides only an overview of the regulations in force at the date of publication, and no action should be taken without consulting the detailed legislation or seeking professional advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material can be accepted by the authors or the firm.