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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'. They may be companies, partnerships or self employed individuals.

The CIS applies to construction work and also jobs such as alterations, repairs, decorating and demolition.

Contractors and subcontractors

Contractors include construction companies and building firms and also government departments and local authorities. From 6 April 2021 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.

Many businesses act as both contractors and subcontractors.

Monthly return

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 it is advisable to make a nil return to avoid HMRC chasing the return or issuing penalties for failure to make a return.

All contractors are obliged to file monthly even if they are entitled to pay their PAYE quarterly.

Identification

Subcontractors must give contractors their name, unique taxpayer reference and national insurance number (or company registration number) when they enter into a contract. So long as the contractor is satisfied that the subcontractor is genuinely self-employed the 'verification' procedure (explained below) must be followed.

Employed or self-employed?

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. HMRC can impose a penalty of up to £3,000 if contractors negligently or deliberately provide incorrect information.

Remember that employment status is not a matter of choice. The circumstances of the engagement determine how it is treated.

The issue of the status of workers within the construction industry is not a new matter and over the last few years HMRC has been making substantial efforts to re-classify as many subcontractors as possible as employees. The courts have considered many cases over the years and take into account a variety of different factors in deciding whether or not a worker is employed or self-employed. The tests which are applied include:

- the right of control over how, what, where and when the work is done; the more control that a contractor can exercise, the more likely it is that the worker is an employee
- whether the worker provides a personal service or whether a substitute could be provided to do that work
- whether any equipment is necessary to do the job, and if so, who provides it
- the basis of payment - whether an hourly/weekly rate is paid, whether there is any overtime, sick or holiday pay and whether or not invoices are raised for the work done
- whether the worker is part and parcel of the organisation or whether they are conducting a task which is self-contained in its own right
- what the intention of the parties is - whether there is any written statement that there is no intention of an employment relationship

- whether there is a mutuality of obligation; that is, an ongoing understanding that the contractor will offer work and the worker accept it
- whether the workers have any financial risk.

As can be seen from the above, there are a number of factors which must be considered and the decision as to whether somebody should be classified as employed or self-employed is not a simple one.

Clearly, HMRC would like subcontractors to be classed as employees, as this generally means that more tax and national insurance is due. However, just because the HMRC think that somebody should be re-classified does not necessarily mean that they are correct.

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

The contractor has to contact HMRC to check whether to pay a subcontractor gross or net. Not every subcontractor will need verifying (see below). Usually it will only be new ones.

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

- gross payment
- a standard rate deduction of 20%
- a deduction made at the higher rate of 30% if the subcontractor has not registered with HMRC or cannot provide accurate details to the contractor and HMRC cannot verify them.

Subcontractors must be verified online and HMRC will give the contractor a verification number for the subcontractors which will be matched with HMRC's own computer. The number will be the same for each subcontractor verified at any particular time. There will be special suffixes for the numbers issued in respect of subcontractors who cannot be verified. The numbers are also shown on contractors' monthly returns and the payslips issued to the subcontractors.

Clearly, these numbers are a fundamental part of the system and contractors have to ensure that they have a fool-proof system in place for obtaining and retaining them. It is also very important to give precise details to HMRC because, if their computer does not recognise the subcontractor, the higher rate deduction will have to be made.

Who needs verifying with HMRC?

If a contractor is paying a subcontractor they will not have to verify them if:

- they have already included them on any monthly return in that tax year; or
- the two previous tax years.

A payslip?

Contractors have to provide a monthly 'payslip' to all subcontractors paid, showing the total amount of the payments and how much tax, if any, has been deducted from those payments. The contractor has to provide this for each tax month as a minimum. Contractors are allowed to choose the style of the 'payslips' themselves but certain specific information has to be provided including the:

- contractor's name and their employer tax reference
- tax month to which the payment relates
- subcontractor's name, unique tax reference or specific subcontractor reference
- the gross amount of the payment
- cost of any materials which have reduced the gross payment
- amount of any tax deductions made; and
- verification number where deduction has been made at the higher rate of 30%.

If contractors include such payments as part of their normal payroll system, it needs to be clear that although payslips are being generated for those individuals, they are not employees and have clearly been classed as self-employed.

Are tax deductions made from the whole payment?

Not necessarily. The following items should be excluded when entering the gross amount of payment on the monthly return:

- VAT charged by the subcontractor if the subcontractor is registered for VAT
- any Construction Industry Training Board levy.

The following items should be deducted from the gross amount of payment when working out the amount of payment from which the deduction should be made:

- what the subcontractor actually paid for materials including VAT paid if the subcontractor is not registered for VAT, consumable stores, fuel (except fuel for travelling) and plant hire used in the construction operations
- the cost of manufacture or prefabrication of materials used in the construction operations.

Any travelling expenses (including fuel costs) and subsistence paid to the subcontractor should be included in the gross amount of payment and the amount from which the deduction is made.

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 as follows:

- a basic penalty of £100 for failure to meet due date of the 19th of the month
- where the failure continues after two months after the due date, a penalty of £200
- after six months the penalty rises to the greater of 5% of the tax or £300
- after 12 months the penalty will again be the greater of £300 or 5% of the tax but, where the withholding of information is deliberate and concealed, it will be 100% of the tax (or £3,000 if greater) and where information is withheld deliberately, 70% of tax (or £1,500 if greater)
- where the return is 12 months late but the information only relates to persons registered for gross payment, the penalty will be £3,000 for deliberate and concealed withholding of information and £1,500 for deliberate withholding without concealment
- where a person has just entered the CIS scheme penalties will be restricted to a maximum of £3,000 in certain circumstances.

Paying over the deductions

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, or the next earlier banking day when the 22nd is a weekend or holiday. 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.

What about subcontractors?

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

To register, a subcontractor needs to contact HMRC by phone or over the internet and they will conduct identity checks.

Gross payment status

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
- £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.

Subcontractors not registered with the HMRC will suffer the higher rate deduction from any payments made to them by contractors.

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.

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