

CIS

EXPLAINED

CONSTRUCTION INDUSTRY SCHEME



WHEN DOES THE CIS APPLY?

If the Construction Industry Scheme (CIS) is to apply, there must be three conditions met:



One party must be a contractor



That contractor must engage with either a self-employed subcontractor or a subcontractor company/partnership



The subcontractor's activity must be in construction operations

If these three requirements are met, the CIS applies. Under CIS, it is down to the contractor to verify the tax status of the subcontractor, including the possible deduction of tax at source from the subcontractor's pay at a rate of either 20% or 30%. The contractor must also file monthly CIS returns and keep detailed records covering the gross amount paid to each subcontractor and any deductions made.



DEFINING A CONTRACTOR



There is a legal definition that can be used. Under Section 59 of the Finance Act 2004 provides the definition of a contractor as "any person carrying on a business which includes construction operations".



In addition to this definition, A person (or a business) spending an average of over £1 million on construction operations in the three years leading up to the end of the last accounts period is also a contractor.



This applies to any company, so a pharmaceuticals company spending £5 million renovating their head office would also be classified as a contractor.



DEFINING A SUBCONTRACTOR

Section 58 of the same Finance Act 2004 also offers a legal definition of a subcontractor. It states that a subcontractor is any body who is “under a duty to the contractor to carry out operations, or to furnish his own labour... or the labour of others in the carrying out of the operations”.

Under this definition, an individual who is self-employed, in business under a partnership, a company or a public body can be a subcontractor.

There is no obligation for subcontractors to be registered with HMRC but if they do not, they will have tax deducted from their pay at a higher rate than those who have registered.



DEFINING CONSTRUCTION OPERATIONS

Again, the Finance Act 2004 offers clear guidance. Under Section 74, a simple Yes/No list makes it easy to determine what is included under construction operations. The general rule, clarified under Section 74(2), states that any “construction, alteration, repair, extension, demolition or dismantling of building or structures” is a construction operation. Also covered by the definition is internal cleaning is within the definition of construction operations as well as the installation of essential systems such as air-conditioning, drainage or fire protection. Repair of these systems is not covered by the definition.

The work of professionals such as architects and surveyors is not a construction operation. However, any fees paid to such professionals for managing the design project are within the scheme according to Section 74(3).

Fitting of carpets and flooring is another example of an activity that is specifically excluded from the definition.



THE TAX STATUS OF THE SUBCONTRACTOR

Without doubt, establishing the self-employed status of a subcontractor is a large issue within the construction industry. Responsibility rests with the contractor to verify the status of the subcontractors they enter into a contract with before any payments are made. By checking Box Six on the contractor's monthly CIS return form, the contractor is verifying that the employment status of each subcontractor has been verified and that no payments are made under contracts of employment.

PAYE overrides CIS and it is understandable that HMRC aims to make sure that individuals and corporations are taxed correctly. If the contractor makes an error in this area, they are liable to a penalty of up to £3,000.

In a test case (Castle Construction (Chesterfield Ltd) v HMRC (2008) UK SpC 723), HMRC argued that 321 workers at Castle Construction were employees of the company and did not fall under self-employment.

Castle Construction appealed and won on several grounds. Firstly, there was no mutuality of obligations and in addition, Castle Construction were under no obligation to offer the workers any work, nor were the workers obliged to accept any offers. Workers were also required to pay for their own clothing, equipment and tools used for work and to rectify any poor workmanship on their own time.



GROSS VERSUS NET

Once the self-employed status of the subcontractor is established, the contractor will need to plan how best to make payments to them. Most subcontractors prefer to be paid the full gross amount and manage their own income tax affair instead of being taxed at source each month. For this reason, it is possible to apply for gross payment status when registering online with HMRC.

In advance of making any payment to a subcontractor, the contractor must, either via HMRC's own software or software available commercially, verify the tax status of that subcontractor.

In return, HMRC will confirm one of the following statuses:



The subcontractor is registered with HMRC and paid gross with no deduction of tax at source



The subcontractor is registered with HMRC and paid net after the deduction of tax at source



The subcontractor is not registered with HMRC and as a result, 30% tax must be deducted at source

In some cases, especially where a subcontractor is late with their self-assessment returns, HMRC will downgrade a subcontractor from gross payment status to net payment status.

Once the subcontractor's tax status has been confirmed by HMRC, the contractor will pay the subcontractor in accordance to their agreement, and the HMRC rules.

Once the status of the subcontractor has been determined the contractor will pay the subcontractor in accordance with the rules.



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