

CHAPTER 25

CONSTRUCTION INDUSTRY DEDUCTION SCHEME

Statutory references in this chapter are to FA 2004 unless stated otherwise.

25.1 Introduction

[FA 2004, s.57 - s.77](#)

The Construction Industry Tax Deduction Scheme is a scheme whereby **contractors** are required to **withhold tax** on certain payments made to **sub-contractors**.

The scheme was originally devised by HMRC in the early 1970's as a reaction to the amount of tax being lost as a result of under-declarations or failures to notify chargeability by sub-contractors who came to work in the UK for relatively short periods and who thereafter left the UK without paying tax on their self employed profits.

The tax deduction scheme ensures that some tax is withheld at the point of payment, thereby **reducing the risk** of a subsequent **default** by the sub-contractor.

The scheme has undergone regular changes since its inception, and a new regime came into effect from 6 April 2007. The rules are contained in Sections 57 to 77 and Sch 11 FA 2004.

25.2 What is a "contractor"?

[FA 2004, s.59](#)

The Construction Industry Deduction Scheme makes it compulsory for "contractors" to **withhold income tax from payments to "sub-contractors" in certain instances**. The first thing we therefore need to be clear upon is who is responsible for operating the scheme - i.e. what is the definition of a "contractor"?

S.59 FA 2004 extends the term "contractor" to a wide range of businesses. A **"contractor" is not solely restricted to "a person carrying on a business which includes construction operations"**.

[FA 2004, s.59\(1\)\(a\)](#)

This means that apart from the obvious businesses such as building and construction companies, **certain other businesses must also comply** with the tax deduction scheme.

A "contractor" will include businesses whose trade does not normally involve building or construction, but **whose average annual expenditure on "construction operations" exceeds £1 million**.

[FA 2004, s.59\(1\)\(i\)](#)

This means that businesses such as banks, supermarkets or retail stores who typically spend more than **£1 million a year** on building works etc, may be required to withhold tax on payments to their sub-contractors.

Local authorities or government bodies such as NHS Trusts can also be regarded as "contractors" for the purposes of the scheme.

Home-owners who engage the services of sub-contractors to undertake building work on their own home, will **not be regarded as a "contractor"** for the purposes of the scheme. This means that the payments made to the sub-contractor for carrying out the work may be made gross.

25.3 What are "construction operations"?

"Construction operations" are defined in s.74 FA 2004, and again **these cover a wide variety of activities**. Construction operations include "construction, alteration, repair, extension, demolition or dismantling of buildings or structures whether permanent or not".

[FA 2004, s.74\(2\)\(a\)](#)

Construction also includes "construction or demolition of, and repairs to, land, walls, roadworks, powerlines, railways and waterways". Work involving the installation of heating, lighting, air-conditioning, drainage or sanitation systems are also caught by s.74, as are cleaning, painting and decorating and other operations which are integral to the construction process, e.g. excavation and site preparation. The definition of "construction operations" therefore covers a multitude of activities.

[FA 2004, s.74\(2\)\(b\)](#)
[FA 2004, s.74\(2\)\(c\),\(e\)](#)

[FA 2004, s.74\(2\)\(f\)](#)

Construction operations do NOT include operations such as drilling for oil or gas, extracting minerals, the manufacturing of components used in the building process or the professional work of individuals involved in the building process (such as architects and engineers). Such exceptions can be found at s.74(3).

[FA 2004, s.74\(3\)](#)

25.4 Sub-contractors

A party to a contract relating to construction operations is a "sub-contractor" if;

[FA 2004, s.58\(a\)](#)

"he is under a duty to the contractor to carry out the operations, or to furnish his own labour or the labour of others in carrying out the operations..."

A sub-contractor can therefore include sole traders, partnerships or companies.

If a sub-contractor carries out work **exclusively for one contractor**, it is highly probable that the sub-contractor will be **regarded as an employee** of the contractor and tax (and NIC) will need to be withheld at source by the contractor under the PAYE system.

The CIS monthly return, which the contractor submits to HMRC, requires a declaration that the contractor has considered the status of the sub-contractor and can verify their self-employment status. HMRC provides an 'employment status indicator' to assist with the decisions necessary in the declarations. This is an electronic tool that can be found on its website, or verification can be done over the phone.

Therefore, before a contractor needs to consider whether the Construction Industry Deduction Scheme applies, he needs to be certain that the sub-contractor in question would not be regarded as an employee under normal "employed versus self-employed" rules.

25.5 Tax treatment of payments

[FA 2004, s.61 - 62](#)

Payments by a contractor to a sub-contractor will either be made:

- **gross**; or
- under **deduction of tax**.

If tax is withheld by the contractor, it will either be withheld at:

- **20%** if the sub-contractor is registered with HMRC;
- **30%** if the sub-contractor is not registered; or
- **under PAYE** if the sub-contractor is treated as an employee of the contractor under the employed v self-employed criteria.

We shall examine each of these in turn.

25.6 Gross payment

Payments by a contractor can be made gross if the sub-contractor is "**registered for gross payment**".

[FA 2004, ss.63, 64](#)

Registration for gross payment will be granted by HMRC if **certain conditions are met**. These are:

[FA 2004, Sch 11](#)

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

25.7 The "business" test

There are two parts to this test:

[FA 2004, Sch 11 para 2](#)

- i) The sub-contractor must be in a business carried on in the UK which **provides labour to carry out construction operations**.
- ii) The business must be, to a substantial extent, **carried on by means of an account with a bank**. Therefore businesses which are substantially "cash based" will not satisfy the business test and will not be able to be registered for gross payment.

25.8 The "turnover" test

The most complex of the three criteria is the "turnover" test. A sole-trader sub-contractor can only make a successful application for gross payment if their business had a **construction turnover of at least £30,000 in the 12 months before making the application** for gross payment. "Turnover" is net of any materials used to earn that income.

[FA 2004, Sch 11 para 3](#)
[SI 2005/2045 Reg 28](#)

In the case of a partnership, the standard test requires a construction turnover of **at least £30,000 for each partner** in the 12 months before the application is made. Therefore a 4-partner practice is eligible for gross payment if turnover exceeds £120,000.

In the case of a company, the standard turnover test is £30,000 **multiplied by the number of directors**. In the case of "close companies" (broadly, companies controlled by five or fewer individuals), the figure will be multiplied by the number of individuals who are directors and/or shareholders. For a husband and wife team, for instance, it would be £60,000.

An alternative test for partnerships and companies is that the business had an **annual net turnover from construction work** (after materials) of **£200,000 or more in the 12 months before application for gross payment**. Therefore, for example, a 10-partner building practice with an annual turnover of £250,000 would be eligible to apply for gross payment.

[SI 2005/2045 Reg 28](#)

In addition, a company or partnership applying for gross payment is treated as passing the turnover test where relevant payments earned in respect of construction operations amount to at least £30,000 and construction contracts have been entered into with a value in excess of £200,000.

[SI 2005/2045, Reg 29\(2\)\(d\)](#)

Businesses that have gross payment status will be subject to periodic reviews to ensure that they continue to meet the requirements. A business is considered to have passed the test if the standard tests described above have been met or if its average annual net turnover in the 3 years ending with the review date exceeds the threshold for its type of business.

[SI 2005/2045, Reg 29\(1\)\(c\)\(ii\)](#)

25.9 The "compliance" test

The business must have kept all **tax affairs up to date** during the **12 months** immediately before the application. This means that the business must have paid all its tax, including any PAYE and sub-contractor deductions, and submitted all tax returns on time. Simply bringing its tax affairs up to date just before sending in the application will not be enough.

[FA 2004, Sch 11 para 4](#)

Minor offences may be ignored - therefore if a return or tax payment is a few days late in one year, this minor offence will not necessarily prejudice the application for gross payment. Certain failures may be ignored if there was a **reasonable excuse** for the failure, for example a sole trader suffering a sudden and serious illness.

For **company applicants**, compliance with tax requirements is supplemented with **additional compliance requirements** dealing with obligations under the Companies Act 2006, including the timely filing of annual returns, accounts and other statutory notifications.

25.10 Verification

[FA 2004, s.69](#)

HMRC needs to be told about contracts entered into between contractors and sub-contractors in order that they can **check that payments are being correctly treated**. A **verification service** exists which enables the **contractor to verify with HMRC whether a sub-contractor is registered for gross payment** or whether tax should be withheld at source.

[SI 2005/2045](#)
[Reg 6](#)

The verification service can be accessed by contractors either by telephone (to a designated HMRC contact centre), in writing or via the Internet. If contact is made by telephone, HMRC aim to give an immediate response. When contacting HMRC for verification, the contractor will need to specify the **name of the sub-contractor together with his NI number and unique taxpayer reference**.

Once HMRC has identified the sub-contractor, HMRC will advise the contractor:

- whether the sub-contractor has **registered**; and if so
- whether payment should be made either **gross or net of tax** at 20%.

If the sub-contractor has not registered, payments should either be made:

- under deduction of tax at a flat rate of 30%; or
- via the payroll if the sub-contractor is effectively an employee.

The verification process is limited to those sub-contractors who have not received payments from the contractor in either the **current tax year or the two preceding tax years**. Sub-contractors who (for example) have worked regularly for a contractor and have received payments in the last 2 years, will not need to be verified. This will mean that contractors do not have the burden of verifying the payment status of a sub-contractor before each and every payday.

HMRC must notify contractors of a change in the status of sub-contractors they have paid within the current or two previous tax years.

25.11 The 20% deduction rate

[FA 2004, s.61](#)

Sub-contractors who are registered with HMRC but are **not registered for gross payment**, will receive payment under deduction of tax at **20%**.

The 20% rate is designed to equate approximately to the average rate of tax suffered by a "typical" sub-contractor, taking into account allowable expenses, personal allowances etc.

The deduction of tax is applied to the labour element - i.e. excluding the cost of materials and any VAT added to an invoice by the sub-contractor. Deduction of tax must also be made from any travelling expenses (including fuel costs) and subsistence paid to the sub-contractor.

Illustration 1

Scott is an electrician and a sub-contractor registered with HMRC under the Construction Industry Scheme. Scott is not registered for gross payment.

Scott submits the following invoice to the contractor for payment:

	£
Labour	2,000
Materials	150
Travelling expenses	<u>125</u>
	2,275
VAT (assume at 17.5%)	<u>398</u>
Invoice total	<u>2,673</u>

The contractor will make a deduction of 20% of the total of the labour and travelling expense elements before paying the invoice amount to Scott:

	£
Invoice amount	2,673
Less: deduction under CIS	
20% x (2,000+125)	<u>(425)</u>
Amount paid to Scott	<u>£2,248</u>

25.12 The 30% deduction rate

[FA 2004, s.61\(3\)\(b\)](#)

The scheme rules recognise that there may be true (non-employed) **subcontractors who have not registered for either gross or net payment** under the scheme and provide for a **second rate of tax deduction** in respect of these subcontractors.

The second rate has been set by Treasury Order at **30%**, and will apply to recipients who are **not registered** under the scheme. This rate is likely to prove a reasonable incentive for recipients to visit their tax office and register.

Payments made to these recipients will also be included on the monthly sub-contractor returns.

As with the 20% deduction rate, the 30% deduction is applied to the labour element (and travelling expenses if relevant) of the sub-contractor's invoice for payment.

25.13 Returns of information and payment of tax

[FA 2004, ss.70-72](#)

The contractor remits deductions of tax from sub-contractors to HMRC on a **monthly basis**. Such remittances must be made 14 days from the end of the tax month (i.e. by the 19th of each month). If the payment is made electronically, the deadline is extended until the 22nd of the month (or previous working day if this is a weekend or bank holiday). The payments will usually be made together with income tax and NIC under PAYE.

The payment must be accompanied by a monthly return from the contractor to HMRC. The return will detail:

- amounts paid to sub-contractors in the period;
- the amount of tax deducted (if any); and
- whether any materials were provided by the sub-contractor.

The returns can either be submitted on paper or via the Internet, electronically using the Electronic Data Interchange.

HMRC will thereafter send a monthly statement to the sub-contractor confirming the amounts paid and any tax deducted. The sub-contractor should check these statements against payment slips etc provided by the contractor. These monthly statements will be linked to the sub-contractor's self-assessment return. Any discrepancies should be reported to HMRC.

All contractors are obliged to submit monthly returns to HMRC (even those who pay their PAYE on a quarterly basis). Nil returns must also be submitted monthly unless the contractor has notified HMRC that he will not be making payments under the scheme for at least a six-month period.

The amounts deducted by the contractor under the scheme must be paid over to HMRC and similar payment rules apply to those for PAYE and NIC. These include **mandatory electronic payment rules for the largest contractors and a quarterly payment regime for the smallest contractors**. Exactly the same provisions apply to mandatory e-payment and the surcharge provisions are identical.

25.14 Late submission of returns and payment of deductions

Finance Act 2009 introduced new legislation dealing with penalties for late filing of CIS returns. The date the legislation will take effect has not yet been determined but you will only be examined on these new rules. Under the new legislation, a fixed penalty of £100 will apply where a return is filed late, with an additional fixed penalty of £200 if the return is outstanding more than two months after the filing date. If the return is more than six months late, a penalty of the greater of £300 or 5% of the deductions due for the return period will be levied. A further penalty of the greater of £350 or 5% of the deductions due will apply if the return is over 12 months late.

[FA 2009, Sch 55](#)
[Paras 7 - 15](#)

If a return is over 12 months late and the information necessary for HMRC to assess the tax has been withheld, a penalty of the greater of £1,500 or 70% of the deductions due will apply. This will increase to the greater of £3,000 or 100% of the deductions due if there has been deliberate concealment.

Where the return is over 12 months late and the 70% or 100% penalties would apply, the amount of the penalties will be reduced if there is disclosure of relevant information by the taxpayer. If the disclosure is unprompted, the 100% penalty can be reduced to a percentage not less than 30% and the 70% penalty to a percentage not less than 20%. If the disclosure is prompted the minimum percentages are 50% and 35% respectively. The actual extent of the reduction will depend on the quality of the disclosure in relation to timing, nature and extent.

The new legislation in respect of late payment of PAYE will also apply to late payment of CIS deductions.

Interest is charged on payments made late under the PAYE provisions. Interest will run from the due date (i.e. from 19th of the relevant tax month) to the day before payment is made.

There is not a requirement for contractors to submit a year-end return to HMRC.

The regime is supported by a **computer system**. The system supports the verification service and facilitates the electronic submission of documentation.

25.15 Payment statements for subcontractors under deduction

[SI 2005/2045](#)
[Reg 4 \(8\)](#)

Where a deduction has been taken from a payment, whether at the 20% or 30% rate, a **statement** must be provided by the contractor to the subcontractor.

A payment statement can be issued with each payment but at least one statement must be **provided each tax month**.

The statement must show the contractor's name and reference, details of the payment(s) made, the cost of any materials incurred and the deduction(s) made from the payment(s).

Statements must be in writing or issued electronically if agreed with the sub-contractor. They must be issued **within 14 days** of the end of the tax month to which they relate.

A penalty of up to £300 may be levied if such statements are not provided, plus a further penalty of up to £60 per day for continuing failure.

25.16 Employment status in the construction industry

The monthly return to HMRC completed by contractors must include a **declaration that none of the payments included on the return is one in respect of a contract of employment**. This places a responsibility on the contractor to examine each subcontractor engagement and to satisfy himself that the relationship is not one of employment. The contractor must do this **before** carrying out the check of subcontractor payment status outlined above.

[FA 2004,
s.70\(2\)\(a\)](#)

25.17 Sub-contractor's tax position

Sub-contractors will file annual personal tax or corporation tax returns at the end of the year in the usual way. If tax has been withheld at source - for example if the sub-contractor is not registered for gross payment - this tax is **treated as a payment on account of income tax and NIC** for the year. Any balance of tax is paid under self-assessment in the usual way.

If the sub-contractor is in a repayment situation - for example if the average rate of tax and NIC on the self-employed profits is less than 20% - a repayment claim can be made.

Where the sub-contractor is a company, if tax has been withheld at source from payments made to the company, this income tax suffered can be **set-off against monthly payments due under PAYE**. If there is insufficient PAYE to cover the tax deducted, the excess can be credited against the end of year corporation tax.

25.18 Interaction with the IR35 rules

If the sub-contractor is a company carrying on construction operations wholly or mainly for one contractor, **HMRC will apply the IR35 rules to the intermediary company in the usual way**. This would most typically apply to one-man companies working primarily for one client.

[ITEPA 2003,
S.48](#)

In this case, the IR35 rules would apply to the intermediary company and deem a salary to have been paid to the worker at the year-end.

Just because a sub-contractor company is caught under the IR35 legislation, it does not mean that the contractor is absolved of his responsibility to withhold tax on payments to the intermediary company. In this case, **the intermediary company may suffer tax at source on payments made to it, and will claim credit for the tax suffered as normal**.