

# THE CONSTRUCTION INDUSTRY SCHEME (“CIS”)

9 May 2023

# SPEAKER



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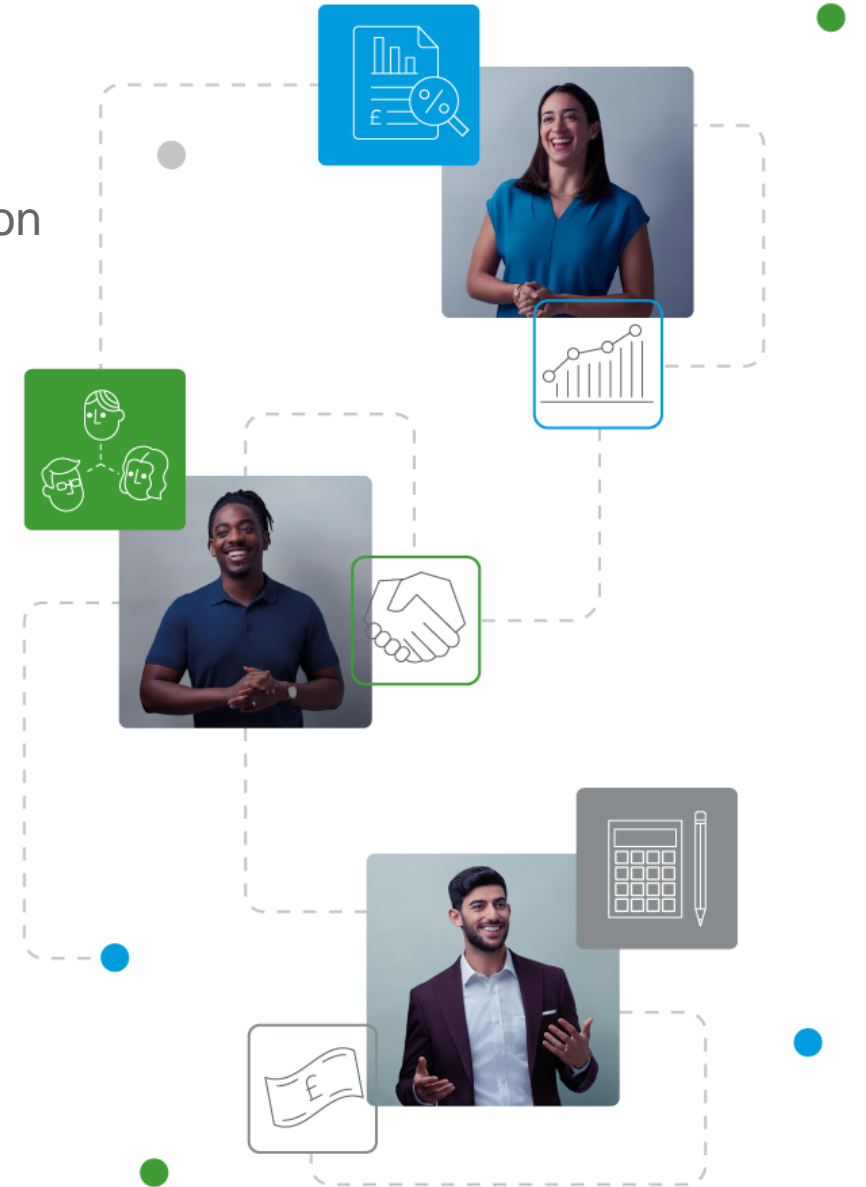
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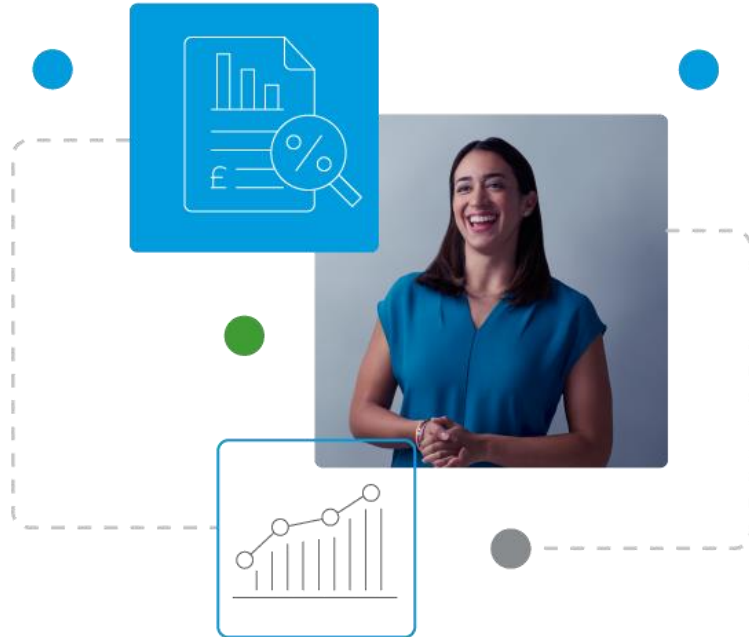
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# AGENDA



1. What is CIS?
2. Overview of the scheme
3. The mechanics of operating CIS
4. Problem areas, and what happens if contractors get it wrong

# What is CIS?

## WHAT IS CIS?

CIS is a potential withholding and reporting regime (overseen by HMRC) covering payments for construction work. Under CIS the definition of construction is widely drawn, and can include repairs and maintenance.

CIS applies to payments made by a contractor to a subcontractor, under a contract which includes construction operations.

Where construction and non-construction work is undertaken under a single contract with a subcontractor, then CIS can apply to the entire contract, however small the construction part.

CIS places various obligations on the contractor and can also affect the cash flow position of the subcontractor.

Contractors must first consider the employment status of subcontractors who are engaged as individuals. Furthermore, the *off-payroll working rules* (“IR35”) will take precedence over the application of CIS.

## EMPLOYMENT STATUS AND 'IR35/OPW'

It is necessary to consider the employment status of subcontractors before CIS.

This applies to self-employed individuals and, under the "IR35/OPW" rules, subcontractors operating via their own intermediary (such as a personal service company).

The Agency Rules must also be considered.

These rules should be assessed first. They take precedence over CIS.

- The employment status of self-employed **individuals** should be considered **before** CIS. If employment status applies, then **PAYE** should be operated instead of CIS.
- From 6 April 2021 new off-payroll working rules ("IR35/OPW") for the private sector must be considered first when an **individual** is personally providing services to an **end-user** via their **own intermediary**.
- The **IR35 rules** apply where the worker **personally provides services** through their **own intermediary**, either directly to the end-user or via another third party (such as an agency).
- The end-user must assess whether the individual would be deemed an employee. The end-user must also operate PAYE for 'inside IR35/OPW' engagements where they are also the fee payer.
- The end-user must also meet other obligations such as issue Status Determination Statements and implement a suitable status disagreement process.
- **N.B risks for labour agencies (employment status / IR35/OPW risks)**

# Overview of CIS

# TYPES OF CONTRACTORS

- Contractors are responsible for operating CIS correctly.
- Contractors are defined in FA2004 S59(1) and FA2004 S57(2)
- Under FA2004 S59(1) there are two main 'types' of contractor :-
  - **Mainstream** contractors – A business which includes the carrying out of construction operations, where construction operations are central to the business model. Subcontractors that are also contractors are normally regarded as mainstream contractors by HMRC.
  - **Deemed** contractors – A business (or other organisation) which is not a mainstream contractor, where construction operations are incidental to the business model and **expenditure on construction exceeds a certain threshold**.
- Under FA 2004 S57(2) a subcontractor who engages other subcontractors is also treated as a contractor.
- Note that a **householder** having construction work undertaken on their own home is not a contractor.
- **Registered charities** are also effectively stopped from being contractors because of SI2005/2045 Reg 24, which specifically excludes from CIS any payments for construction operations made by a charity. **This exclusion does not extend to any trading arm of the charity.**



# DEEMED CONTRACTOR THRESHOLD

VAT exclusive expenditure on construction operations exceeds **£3,000,000 in a rolling 12-month period.**

## Deemed contractor

- Must register when expenditure on construction operations exceeds, or is expected to exceed, this threshold.
- This is subject to a potential 90 day grace-period which can be agreed with HMRC.
- Then required to operate CIS on payments to subcontractors unless “Regulation 22” applies.

## EXAMPLE 1

Company A is not a mainstream contractor. Over recent months (starting in May 2022) it has nonetheless incurred significant construction expenditure when engaging subcontractors to undertake construction work.

Company A must review and monitor its construction expenditure to see if it reaches the £3 million threshold within the previous 12-month period. If it does or will, exceed the threshold then Company A becomes a deemed contractor.

Company A monitors its construction payments over the previous 12 month period to 5 November 2022, which are as follows:

Date	Payment	Cumulative total
May 2022	£620k	First construction payment
June 2022	£700k	£1.32 million
July 2022	£600k	£1.92 million
Aug 2022	£250k	£2.17 million
Sept 2022	£550k	£2.72 million
Oct 2022	£250k	<b>£2.97 million</b>
Nov 2022	£150k	<b>£3.12 million</b>

In October 2022 the cumulative spend on construction is nearing the £3m threshold. Company A should register now if further construction is likely and it expects to exceed the threshold. The deemed contractor threshold is actually exceeded in November 2022, and Company A becomes a deemed contractor and is required to register as a contractor immediately unless HMRC agree to apply the grace period.

# SUBCONTRACTORS

## Subcontractor

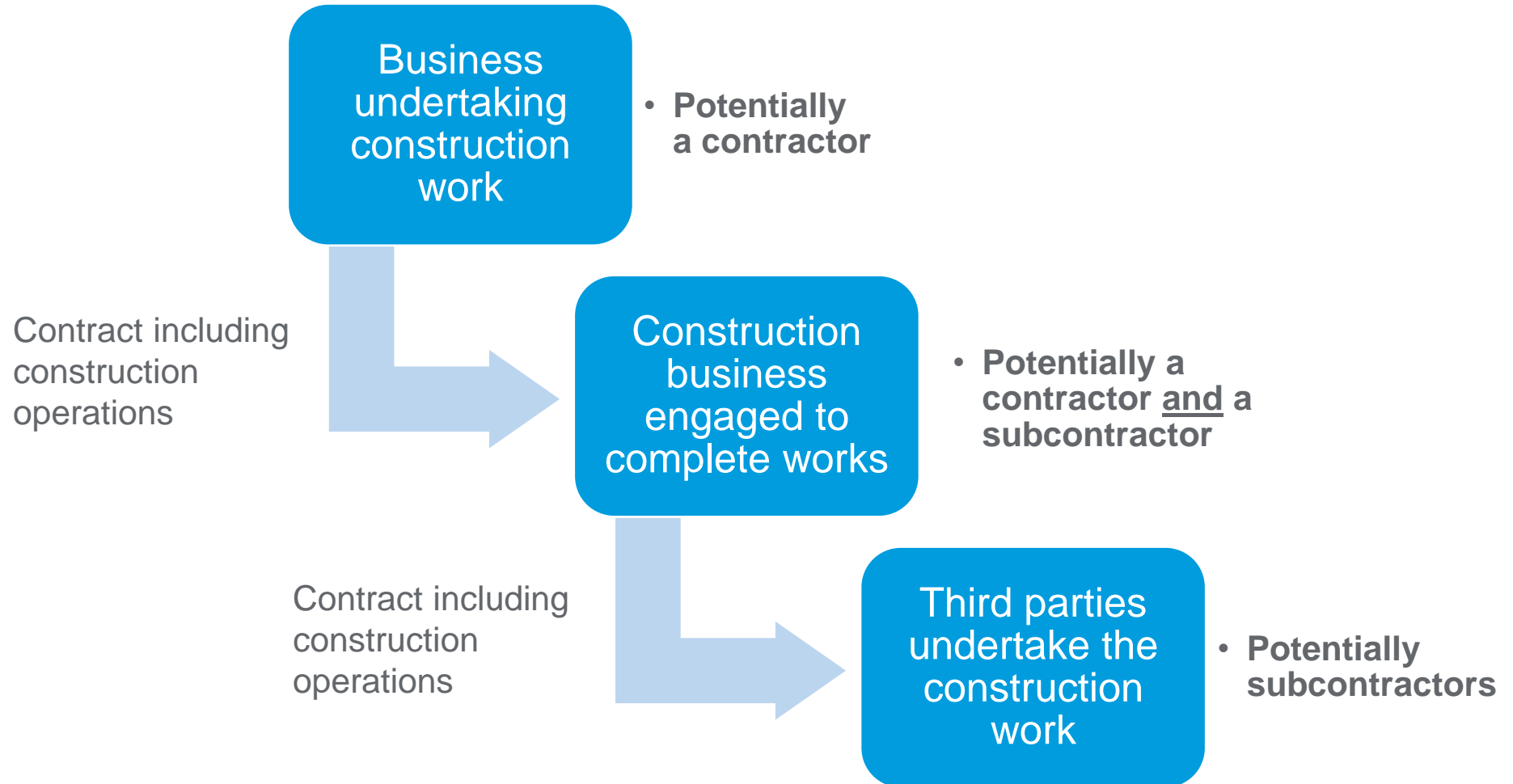
The party to a construction contract with a contractor that carries out, or provides labour for construction operations, or is answerable to a contractor for the carrying out of construction operations. Defined at FA 2004 S58.

The subcontractor may be carrying out the construction operations in different ways (i.e. using its own employees, engaging third parties etc).

Three types of subcontractor:-

- Those registered to receive payments **gross**;
- Those registered **net** or '**standard**' – they can receive payment after deduction of CIS tax at the **20%** rate; and
- **Unregistered** – they can receive payment after deduction of CIS tax at the **30%** rate.

# EXAMPLE OF CONTRACTOR/SUBCONTRACTOR RELATIONSHIP



# CONTRACTS FOR CONSTRUCTION OPERATIONS

Any legally binding agreement or contract between a contractor and subcontractor under which the subcontractor executes, or arranges the execution of, or supplies labour for, construction operations. Defined in FA 2004 S.57(2).

Even if the construction operations element only forms part of the overall contract.

Under the definition of a contract payment (FA 2004 S60) a payment under an employment contract is exempt from CIS.

# CONSTRUCTION OPERATIONS

The **definition** of construction operations in FA2004 S74(2) is **widely drawn**. It includes:

- Site preparation;
- Alterations;
- Installation (in any building or structure) of systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection;
- Dismantling;
- Construction;
- Repairs;
- Decorating;
- Finishing works; and
- Demolition.

It will cover almost any work of this type done to a permanent or temporary building or structure, or to the land. The work must be in the UK or within UK territorial waters. FA2004 S74(3) sets out what is excluded from the definition of construction operations.

# SMALL PAYMENTS EXEMPTION

Under SI2005/2045 Reg 18 deemed contractors may be authorised not to apply CIS to small contracts for construction operations.

This depends on **approval** by HMRC, subject to satisfying the following conditions:

- The contractor is a **deemed contractor**.
- Any contract to which the arrangement applies has a value **not exceeding £1,000** after deducting the cost of materials.

# CONSTRUCTION OPERATIONS – BUILDING SYSTEMS

Systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply, or fire protection.

**Installation** is generally within the scope of CIS but **repair** work is generally not. But consider facts of each case.

**Replacement** of such a system is within CIS. Replacement of a component part of such a system (such as a boiler within a system of heating) is outside the scope.

**Extension** of an existing system is, in isolation, outside the scope of CIS but can often be caught as part of a single contract to extend a building.

**Installation** of structural fire protection systems is within CIS.

**Installation** of fire alarm systems **limited** to providing **audible/visible** warnings are not within CIS.

**Don't forget the mixed contract rule.**



# CONSTRUCTION OPERATIONS – PROFESSIONAL SERVICES

The professional work of architects, surveyors, and consultants in building, engineering, interior or exterior decoration, or landscaping are **excluded** from CIS.

Other professionals are excluded if their services are consultative only and they stand apart from the execution of the construction work.

Some professionals do not provide **purely consultative** services.

It is not always clear if professionals are working solely within their professional disciplines.

Their services are **within the scope** of CIS if they (for example) **manage or supervise** the construction work. For example, certain project managers.

**Don't forget the mixed contract rule.**

## WHAT ABOUT REG 22?

Payments for construction operations made by certain **deemed contractor businesses** to subcontractors may be exempt from CIS under SI2005/2045 Reg 22. Where the payment relates to property used for the purposes of the deemed contractor's business, or for the business of:-

- other companies within the same group; or
- any company of which 50% or more of the shares are owned by the company.

Payments covered by this exemption might include (subject to understanding the business) those relating to:-

- Offices;
- Warehouses;
- Nursing homes;
- Factories;
- Restaurants.

Note, this is not an exhaustive list.

Reg 22 does **not** apply to the following types of payment:

- For property that is not used for the purposes of the business – e.g. where it is let for commercial purposes to a third party, unless that letting is incidental to the business.
- Property that is for sale.
- Property that is held as an investment.

**Reg 22 cannot be applied to payments by mainstream contractors and by other bodies treated as deemed contractors under FA 2004 S59(1)(b)to(k) such as local authorities)**

# DEREGISTRATION AS A DEEMED CONTRACTOR

A deemed contractor may deregister from CIS if their expenditure on construction operations falls below the £3 million threshold in the previous rolling 12-month period and no further construction by the business is expected to be undertaken which would cause it to exceed the £3 million threshold.

HMRC guidance says that to deregister deemed contractors must contact the CIS Helpline on 0330 200 3210.

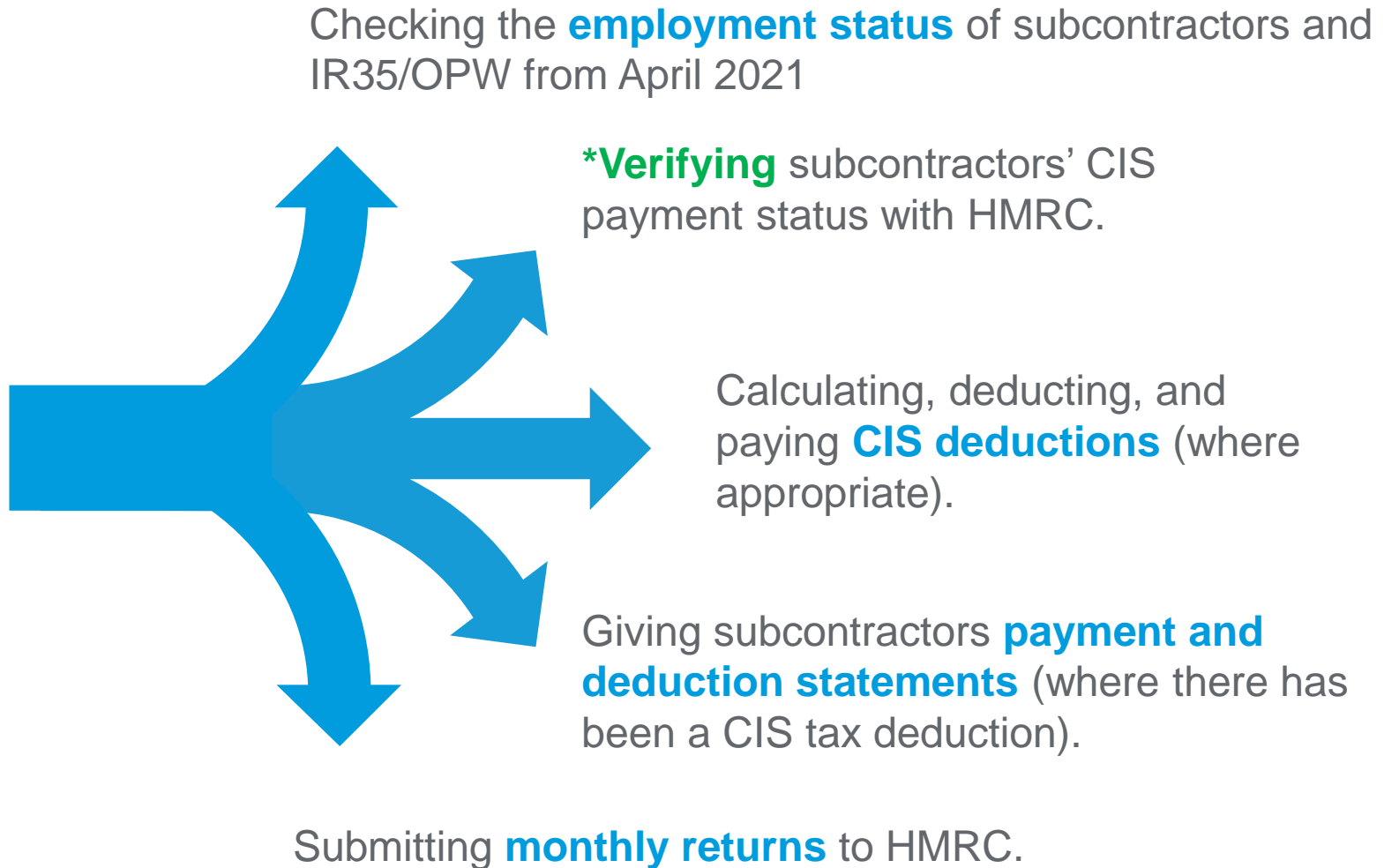
If construction work should decrease or cease for short periods of time HMRC recommends that businesses do not deregister from CIS but instead use the facility to have a **temporary 6 month period of inactivity applied**. See [CISR61280](#).

# The mechanics of operating CIS

# CONTRACTOR OBLIGATIONS - OVERVIEW

Contractors have legal obligations under CIS.

Failure to meet these obligations can lead to unexpected liabilities and/or penalties.



**\*Verifying** subcontractors allows a contractor to determine the rate of CIS tax to deduct (20%, or 30%)

# HOW DO YOU VERIFY

To complete the CIS subcontractor verification process you will request the following information from your subcontractor to give to HMRC:

- **Name**
- **UTR** (Unique Tax Reference)
- **Companies House Number** (if limited company)
- **National Insurance Number** (if a sole trader or partnership but not essential for verification)

To verify a subcontractor you can use the HMRC website

## Subcontractor Details - Company

By providing the 'Unique tax reference' and/or 'Company registration number' below, you are more likely to receive a successful response to your verification request.

Company/trading name:

Unique tax reference (UTR): (optional)

▶ [Help about: 1057 - Company Unique Taxpayer Reference \(UTR\)](#)

Company registration number (CRN): (optional)

▶ [Help about: 1262 - Companies House Registration Number \(CRN\)](#)

Works reference number: (optional)

▶ [Help about: Works Reference Number](#)

To provide more details for your personal records, please click the 'Provide more details' button below.

**Next**

Provide more details

[Your HMRC services](#)

> [Construction Industry Scheme](#)

**CIS Returns**

[Subcontractor List](#)

[Verify Subcontractor](#)

[Monthly Return Overview](#)

[Submitted Returns](#)

[Submitted Verifications](#)

[Contractor Details](#)

[Feedback](#)

# CONTRACTOR OBLIGATIONS – DEDUCTING CIS TAX

If **net payment status applies, or subcontractors cannot be verified**, CIS tax must be deducted.

The **contractor is responsible** for calculating the correct CIS tax.

The amount from which the deduction is calculated excludes VAT. The starting point is to consider the VAT exclusive total of **payments made** during the tax month.

First deduct any **actual** amounts the subcontractor has **directly incurred** for **materials**, fuel for plant, **externally hired plant**, consumable stores, and the cost of manufacturing or prefabricating materials.

The rate of deduction advised by HMRC must then be applied (per the verification process) to the remaining amount.

CIS tax is payable to HMRC by 22<sup>nd</sup> of the month following the tax month. Details for how to make payments are here: <https://www.gov.uk/pay-payee-tax>

# CIS DEDUCTIONS AND MATERIALS

- A deduction should not be applied to that part of the payment representing the direct cost of **materials** to the subcontractor.
- 'Direct cost' means what the subcontractor can demonstrate they have **directly paid** for the materials.
- The materials must specifically relate to the construction contract to which the payment is being made by the contractor.
- The materials therefore cannot relate to other construction contracts lying beneath that contract tier.
- The contractor can be held responsible for any CIS tax underpaid if incorrect treatment is applied.



# CIS DEDUCTIONS AND PLANT HIRE

- Where a subcontractor has to hire plant in order to carry out construction work.
- The cost of the plant hire and any consumable items such as fuel needed for its operation, may be treated as materials.
- For the purpose of the contractor calculating any CIS tax deduction.
- Must be plant and equipment **actually hired by the subcontractor.**
- If the subcontractor owns the plant employed in executing the work no 'notional' deduction for plant hire may be made, although consumable items such as fuel used by the plant may still be treated as 'materials'.
- The contractor can be held responsible for any CIS tax underpaid if incorrect treatment is applied.

## WHAT ABOUT OTHER EXPENSES?

Where a construction contract places an obligation upon a contractor to pay a subcontractor's expenses (such as travel, subsistence and accommodation expenses) such payments form part of the overall value of the contract, by virtue of FA 2004 S60.

### **Example**

The value of a construction contract is £10,000, including the payment of the subcontractor's accommodation expenses. The subcontractor's hotel accommodation costs £1,000. The contractor pays £1,000 directly to the hotel, leaving £9,000 due to the subcontractor. The contractor should make a CIS deduction at the appropriate rate - 20% in this example. The deduction will be £2,000, based on total payments of £10,000. The contractor should give the subcontractor a payment and deduction statement showing a gross payment of £10,000, with CIS deductions of £2,000. The subcontractor will receive £7,000.

# DEDUCTION STATEMENT

The CIS payment and deduction statement must show the following information:

- The contractor's **name**
- The contractor's **employer tax reference number**
- The **month** to which the payment relates, for example, the month-end October 2022
- The **subcontractor's unique tax reference** number
- The **verification number** provided by HMRC during the verification process (only required for higher rate deductions at 30%)
- The **gross** amount
- The CIS **qualifying materials** amount
- The **CIS tax** amount

Where subcontractors have gross payment status there is no requirement to issue a CIS Payment and Deduction Statement.

**Construction Industry Scheme  
Payment and deduction statement**

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**Contractor details**

Contractor's name

Contractor's address

**Payment and deduction made in tax month ended  
05 MM YYYY**

05

**Employer's Tax Reference**

/

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**Subcontractor details**

Subcontractor's full name

Unique Taxpayer reference (UTR)

Verification Number\*  
V          /

\* Verification number only to be entered where a deduction at the higher rate has been made.

**Gross amount paid (Excl VAT) (A)**

£

**Less cost of materials**

£

**Amount liable to deduction**

£

**Amount deducted (B)**

£

**Amount payable (A-B)**

£

Subcontractors - Please keep this document safe

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# CONTRACTOR OBLIGATIONS – MONTHLY RETURNS

## Monthly Return - Print

### Monthly Return for period ended 5th May 2021

This monthly return was submitted on 13/05/2021.

Your IRmark is: [REDACTED]

Number of subcontractors: 1

Name	Verification number	Total payments made (does not include VAT)	Cost of materials (paid for by subcontractor)	Total tax deducted
[REDACTED]	V1236 [REDACTED]	11,357.00	0.00	0.00
<b>Totals</b>		<b>11,357.00</b>	<b>0.00</b>	<b>0.00</b>

Use your browser's 'save as' option to save this monthly return.

Print Close

- Monthly CIS returns are **due by 19th of the month** following the end of the relevant tax month.
- Tax months end on the 5th of each month. Eg for the month ended 5 June, the return is due to HMRC by 19 June.
- CIS returns **report all payments within the scope of CIS** that were made **during the tax month**, even if no CIS tax deductions are required, as well as allowable deductions and CIS tax liabilities.
- Also nil returns are required but a period of inactivity can be applied for.
- If there is a CIS tax deduction, a **payment and deduction statement** must be provided to the subcontractor by the 19th.

**Problem areas, and what happens if contractors get it wrong?**

## PROBLEM AREAS

Scope of the definition of construction operations

Single contract rules

Deemed vs mainstream contractor

Monitoring the deemed contractor threshold

Making deductions and risks in relation to materials and plant hire

Robust verification process

Landlord contributions to tenants

Inter-group arrangements and payments

# HMRC CIS ENFORCEMENT - IMPLICATIONS

- Late CIS return penalties (see later slide)
- Contractor compliance failures can lead to **loss of gross payment** status if also a subcontractor.
- HMRC hold contractors **culpable for under deducted CIS tax**.
- HMRC can go back **six years** to collect underpaid CIS tax in this way if the contractor's behaviour is **"careless"**.
- Penalties and interest charges can be applied to the under-deducted CIS tax.
- **An offset for the tax** paid by subcontractors ("**Regulation 9**" claims) are not guaranteed.

# HMRC ENFORCEMENT – EXAMPLE: LATE FILING OF RETURN

Where a monthly CIS return is filed late, the penalties can be applied as follows:

Time period	Penalty
Automatic late filing	£100
2 months	£200
6 months	£300 or 5% of any liability to payments that should have been shown in the return (whichever is higher)
12 months	£300 or 5% of any liability to make payments that should have been shown in the return (whichever is higher).  For returns later than 12 months HMRC can also impose an additional penalty of up to £3,000 or 100% of the deductions on the return, whichever is higher (and depending on reason for late filing*)

\*Level of penalty for late filing after 12 months will be dependent on whether the Company's behaviour was:

- Non-deliberate;
- Deliberate; or
- Deliberate and concealed



## HMRC ENFORCEMENT – EXAMPLE: INACCURATE RETURN

Where there is an error in a monthly CIS return which has resulted in an under-calculation of CIS deductions, the penalties can be applied as follows:

Behaviour	Maximum penalty percentage*
Deliberate and concealed	100%
Deliberate but not concealed	70%
Not deliberate and not concealed	30%
Mistake despite reasonable care	Nil

\*Higher penalties apply for certain offshore matters

# POTENTIAL CIS REFORM

[HMRC consultation](#) published 27 April 2023. Closes 20 July 2023. Proposes reforms and seeks feedback.

## Strengthening gross payment status rules

- VAT compliance as part of the compliance tests on application and annually
- First annual compliance review at 6 months rather than 12 months
- Legislation to prescribe the channels through which such applications are made, with an eventual move to digital applications.

## Payments from landlords to tenants

- Tenant vs landlord works
- Tenant works may be exempt
- Current rules cause problems
- Easements to simplify and address anomalies and complications

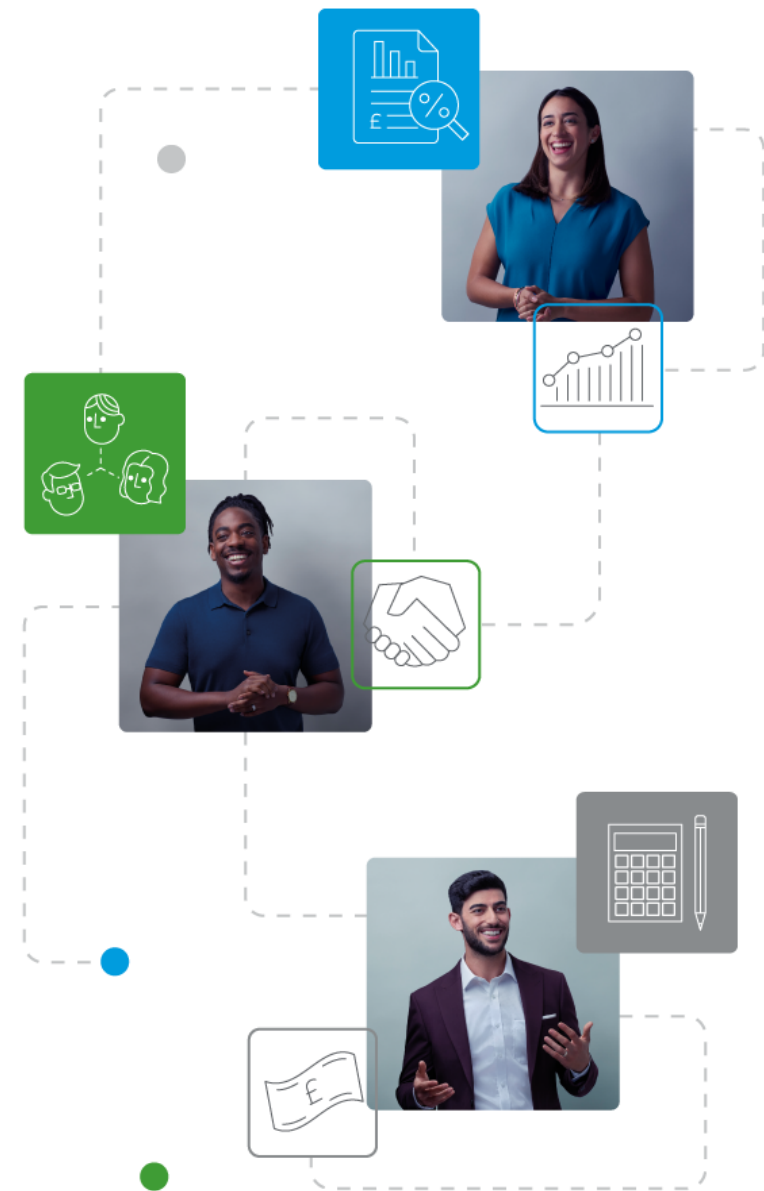
## Groups

- CIS compliance can be burdensome for larger groups
- Where nature of business means infrequent construction payments by different members
- CIS grouping rules proposed for certain group entities proposed

## Further simplification?

- Other anomalies
- Disproportionate administrative problems
- Balance business burdens with Exchequer protection
- Feedback required

# Q&A



# SPEAKER



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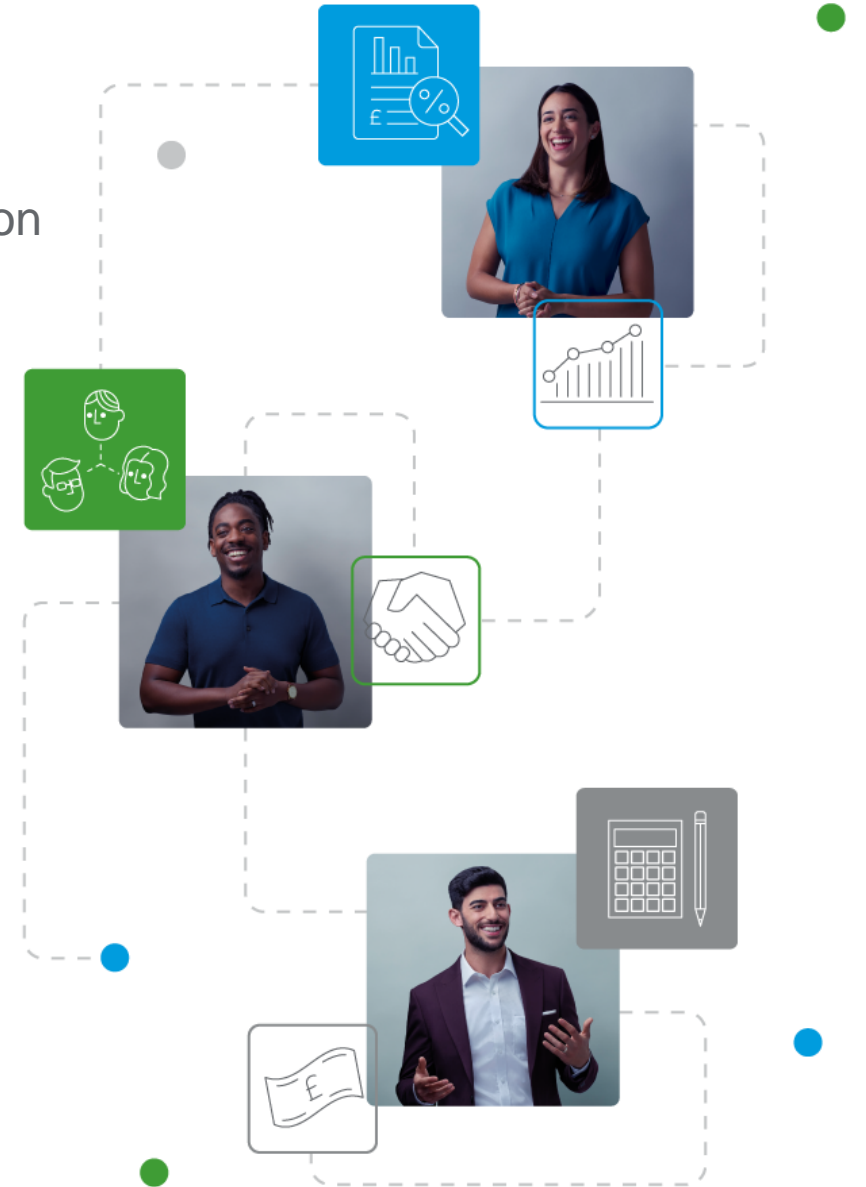
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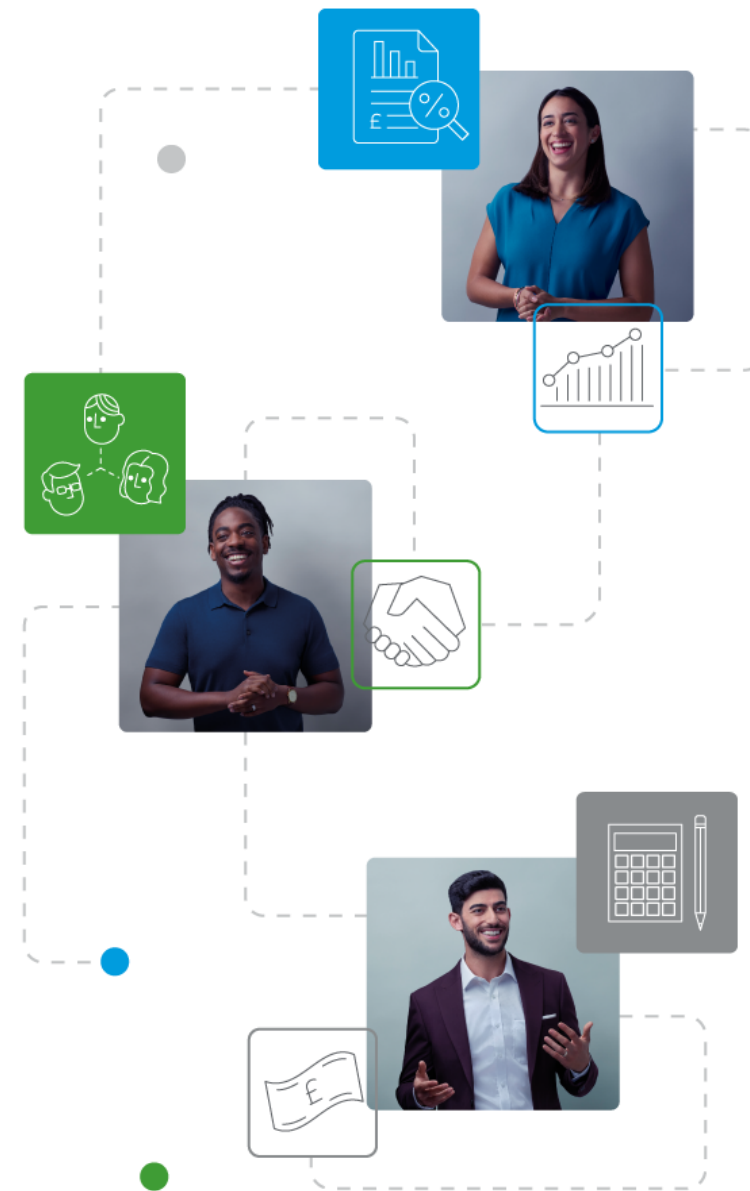
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# Thank you



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