

Going into the construction industry

The construction industry scheme

There are special tax rules affecting the construction industry, which are designed to ensure that tax is paid by workers in the sector whether they are employed or self employed. The Construction Industry Scheme places obligations on contractors - those who engage labour for construction work - and failure to operate the scheme correctly carries very significant financial penalties.

Construction contract

Tax must be deducted at source from a payment under a construction contract, which is a contract between a contractor and a subcontractor for construction services. The definition of construction services for this purpose is very wide and includes not only obvious building work but also, for example, the cleaning of newly constructed premises before the occupiers move in, and landscaping associated with building projects. There is detailed guidance in the HM Revenue and Customs booklet CIS 340 to help you decide whether you are carrying on construction operations or not.

Contractors

For the purposes of the construction industry tax scheme, the contractor is the person who makes payments to subcontractors for construction work. Contractors are required to register under the scheme and to operate the scheme on any payments made. Contractors are required to make monthly returns of payments made under the scheme. It is important to note that it is possible to be both a contractor and a subcontractor, where 'engaged' within a 'chain' of businesses on a construction project. In this case it is necessary to make deductions from payments made even if deductions may be suffered on payments received. The arrangements for offsetting these tax deductions against each other depends on whether the business is a limited company or not.

Subcontractors

Subcontractors are engaged to provide labour on a construction project. It is not possible to be a subcontractor in a 'materials only' supply. In this case it is necessary to register under the scheme and, subject to meeting certain criteria, the business may qualify to be paid without deductions.

Contractors - what you must do

Research by the sector skills councils has revealed the 2012 Olympics needs around 13,000 construction workers and 1,500 electricians and plumbers a year between now and 2012.

Register as a contractor

The first step is to register for the scheme. This is necessary before anyone is paid under the scheme. If the business already has a payroll for employees, the registration process will require the payroll reference. Once registered returns are required on a monthly basis (more details of this follow). The penalty for late registration can run into thousands of pounds as the contractor will be fined for each late monthly return.

Employment status

When someone is engaged to provide labour on a construction project checks must be carried out to establish their employment status. This does not apply if the subcontractor is a limited

company, but otherwise guidance should be sought from HM Revenue and Customs to help you decide. The Construction Industry Scheme only relates to self employed workers, and employees should be placed on the payroll and have PAYE and NIC deducted. There is more detail on this often difficult area in Employed or Self Employed.

Verification

Once the person's employment status is determined, it is necessary to establish whether tax should be deducted from payments and what rate. This requires basic details from the subcontractor, including the name of the individual or business through which the trade is conducted, the unique taxpayer reference (UTR) number applying to the business and the national insurance number for individuals or company registration number of a limited company.

When a subcontractor is engaged for the first time, it is necessary to contact HM Revenue and Customs to verify the tax status of subcontractor. The response will advise whether the subcontractor is registered for gross or net payments. Some subcontractors will be 'unmatched' as a response which can mean either that the identity information may be incorrect, or that the person is not registered under the scheme. Verification responses include a verification number, which should be retained.

Once verified, payments to the subcontractor can continue without further verification so long as a payment was made in the current or two previous tax years. HM Revenue and Customs will advise, in writing, if the registered tax status of any of the subcontractors changes otherwise the same tax treatment should continue to apply

Paying subcontractors

When a subcontractor is registered for gross payment there is no need to make any deductions from payments; but payments must not be made to anyone else, such as a nominee at the request of the subcontractor without first checking the nominee's CIS status.

Where a subcontractor is registered for net payment CIS tax at a rate of 20% should be deducted from the full amount of the payment made less a deduction for the cost of materials. Tax must be deducted from any profit element on materials, and also from allowances for travel. However, if the subcontractor is registered for VAT, no deduction is made from the VAT element of invoices.

Where a subcontractor is unmatched, tax at 30% will apply to the payment. However, it is worth checking the details used, as it may be that an error was made when asking for verification. If a 30% deduction applies, then the verification number will need to be recorded against the payment and provided to HM Revenue and Customs and the subcontractor with details of the payment.

Contractors must issue a payment statement to each subcontractor who has suffered tax on payments. The statement may cover all payments in a tax month, or each individual payment. Although there is no prescribed format, payment statements must include certain information, and HM Revenue and Customs provide a suitable format on the internet at www.hmrc.gov.uk. There is a penalty for failure to issue payment statements to subcontractors.

Returns

Each tax month, contractors are required to make a return of all payments to subcontractors, including those that did not suffer tax on payments. The return can be made on paper or online, but must be filed within 14 days of the end of the tax month - that is by 19th of each month. Nil returns are required when no payments have been made. The penalty for late returns is a minimum of £100 per month late.

The return also includes declarations by the contractor that all subcontractors needing verification have been verified, and that employment status has been considered, and that none of the subcontractors listed is an employee.

Contractors who do not expect to make payments under the scheme for at least six months can register as inactive, but will be fined if they forget to notify HM Revenue and Customs if this situation changes before the six months expires.

Compliance issues

Contractors who also work as subcontractors should be aware that compliance failures as contractors can affect their status as subcontractors, and may lead to losing gross payment status.

Subcontractors - what you must do

Registration

It is not necessary to register under the Construction Industry Scheme if work is only undertaken directly for private customers, as they are not liable to operate the scheme. Otherwise, the consequence of not registering under the scheme is that 30 percent tax will be deducted from any payments received. In order to receive payment without deduction of tax it will be necessary to satisfy a number of additional tests.

Registration can be initiated by contacting HM Revenue and Customs process you can telephone the Revenue and Customs CIS helpline on 0845 366 7899, which is available seven days a week. You will need to provide your National Insurance number to obtain registration. If you do not have a National Insurance number you will need to visit a tax office in person with proof of identity.

Registration for gross payment
Established businesses in the construction sector can apply to register for gross payment. Once registered, payments will be made without deduction of 20% CIS tax. In order to register for gross payment, the subcontractor needs to satisfy:

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

The business test is relatively easy to satisfy - it is necessary to demonstrate that there is an established business supplying construction services in the UK which is run largely through a bank account. The turnover test requires that in the 2 month period before application the construction turnover (excluding cost of materials and VAT) exceeded £30,000, or £30,000 per partner or director for a partnership or limited company respectively. For a large partnership or company, the maximum turnover limit is £200,000.

The compliance test

The business and owner(s) must be up to date with all of tax obligations in order to register for gross payment - the test looks at the 12 months preceding the date of application and requires that all returns have been filed on time by the applicant(s), and that all tax due has been paid on time. Further, if asked for information by HM Revenue and Customs, this was provided as requested.

Once registered for gross payment, the turnover and compliance conditions are reviewed on a regular basis (at least once a year), and if a subcontractor is found to be in breach then HMR Revenue and Customs will withdraw net payment status. Unless the subcontractor appeals against this ruling, the change of status will be notified to all contractors who have used the contractor's services in the current or two previous tax years, with the consequence that a tax deduction of 20% will be made on all future payments.

In looking at the compliance history of subcontractors, HM Revenue and Customs do ignore some minor breaches of the rules, so any or all of the following in the 12 month review period would be ignored:

- Three late submissions of the CIS contractor monthly return, including 'nil' returns - up to 28 days late
- Three late payments of CIS/PAYE deductions - up to 14 days late
- One late payment of Self Assessment tax - up to 28 days late
- Any employer's end of year return made late
- Any late payment of Corporation Tax - up to 28 days late, including where any shortfall in the payment has incurred an interest charge but no penalty any Self Assessment return made late
- Any payment not made by the due date, where it is less than £100.

Keeping records

Whenever a payment is received from which tax has been deducted, the contractor has an obligation to provide a payment advice showing the details of the payment and the tax deducted. This can be provided for each payment, or otherwise on a monthly basis (for each tax month). It is important that these payment advices are retained as they include details of the tax deducted which is then available for offset against your tax liabilities.

Limited company subcontractors can deduct the tax suffered from any payments of PAYE, NIC or CIS tax due to be made to HM Revenue and Customs or otherwise reclaim this tax at the end of the tax year after submitting the end of year payroll return. Any other tax owing will be withheld before a repayment is made.

For advice, do please contact us.