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Ystyriaethau Cynllun y Diwydiant Adeiladu (CIS) mewn contractau Construction Industry Scheme (CIS) considerations in contracts



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1. What is CIS?

The Construction Industry Scheme (CIS) is a tax withholding and reporting regime that applies to payments from contractors to subcontractors, made under contracts which include construction operations undertaken within the UK or UK territorial waters.

The CIS is aimed at preventing evasion of tax by subcontractors working in the industry and who are unknown to HM Revenue & Customs (HMRC). The essence of the Scheme is that on behalf of HMRC, deductions are made by contractors at one of two prescribed rates from payments made to subcontractors engaged in construction operations carried out within the United Kingdom. **These deductions are reported and paid on to HMRC and count towards the subcontractor's overall tax and National Insurance liability.**

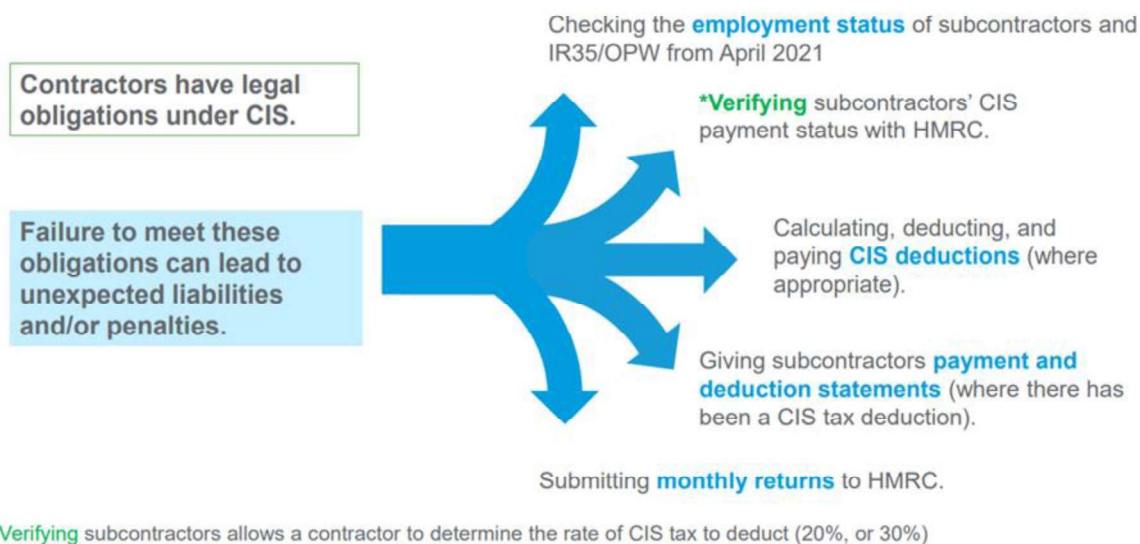
Avoiding Pitfalls: Mistakes by contractors can be costly as they can be held liable for CIS tax under deducted from contract payments to subcontractors. If reasonable care has not been exercised, HMRC is able to recover that CIS tax for up to six years from the end of the tax year it relates to, together with interest charges and penalties.

2. Contractors & Subcontractors

Contractors

Contractors are responsible for operating CIS correctly.

CONTRACTOR OBLIGATIONS - OVERVIEW



The regulations stipulate that contractors involved in construction work must register under the scheme for tax purposes.

Under the Finance Act 2024 (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. **Carmarthenshire County Council is a deemed contractor.**
- Under FA 2004 S57(2) a subcontractor who engages other subcontractors is also treated as a contractor.

Subcontractors

Subcontractors who satisfy certain conditions and whom HMRC has good reason to believe will pay tax on their profits through the normal processes are able, on application to receive payments due to them in full. Such subcontractors are referred to as 'Gross Payment subcontractors'.

Those subcontractors who do not meet the conditions to be paid gross are still expected to make themselves known to HMRC and register to be paid under deduction. Those subcontractors are referred to as 'Net Payment subcontractors' or 'subcontractors paid under deduction'.

In addition to Gross Payment and Net Payment subcontractors, there are those subcontractors who have failed to register at all for the new Scheme. These subcontractors are known as 'un-matched' or 'un-registered' subcontractors. Un-matched subcontractors have deductions made from their payments at a higher rate until such time as they can be verified successfully.

Within 14 days of the end of the tax month in which the payment, or payments, were made, the contractor gives a 'payment and deduction statement' to the subcontractor, showing how much has been paid and how much was deducted for the tax month just ended.

Subcontractors have to make a return of their profits each year, and their tax liability is based on that return. A subcontractor may already have paid tax by payments on account or had deductions made, as shown on the payment and deduction statements given to them by their contractors. If the amount already paid or deducted is greater than the amount due, HMRC will repay the excess. If there is a shortfall, then the subcontractor must make a balancing payment.

3. What are construction operations?

Under HMRC's Construction Industry Scheme (CIS) regulations, "construction work" encompasses a range of activities related to the building and construction of buildings, structures, and civil engineering works.

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 (see Systems section below for further details)
- Dismantling
- Construction
- Repairs
- Decorating
- Finishing works
- Demolition

It will cover almost any work of this type done to a permanent or temporary building or structure, or to the land.

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.

Professional services

- The professional work of architects, surveyors, and consultants in building, engineering, interior or exterior decoration, or landscaping are excluded from CIS (architects who also manage a project for a contractor are no longer exempt from CIS. In this case, the architect is acting as a project manager or developer).
- 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.

Certain activities, such as the manufacturing of building materials or office work, typically fall outside the definition of construction work under the CIS but see section on mixed contracts.

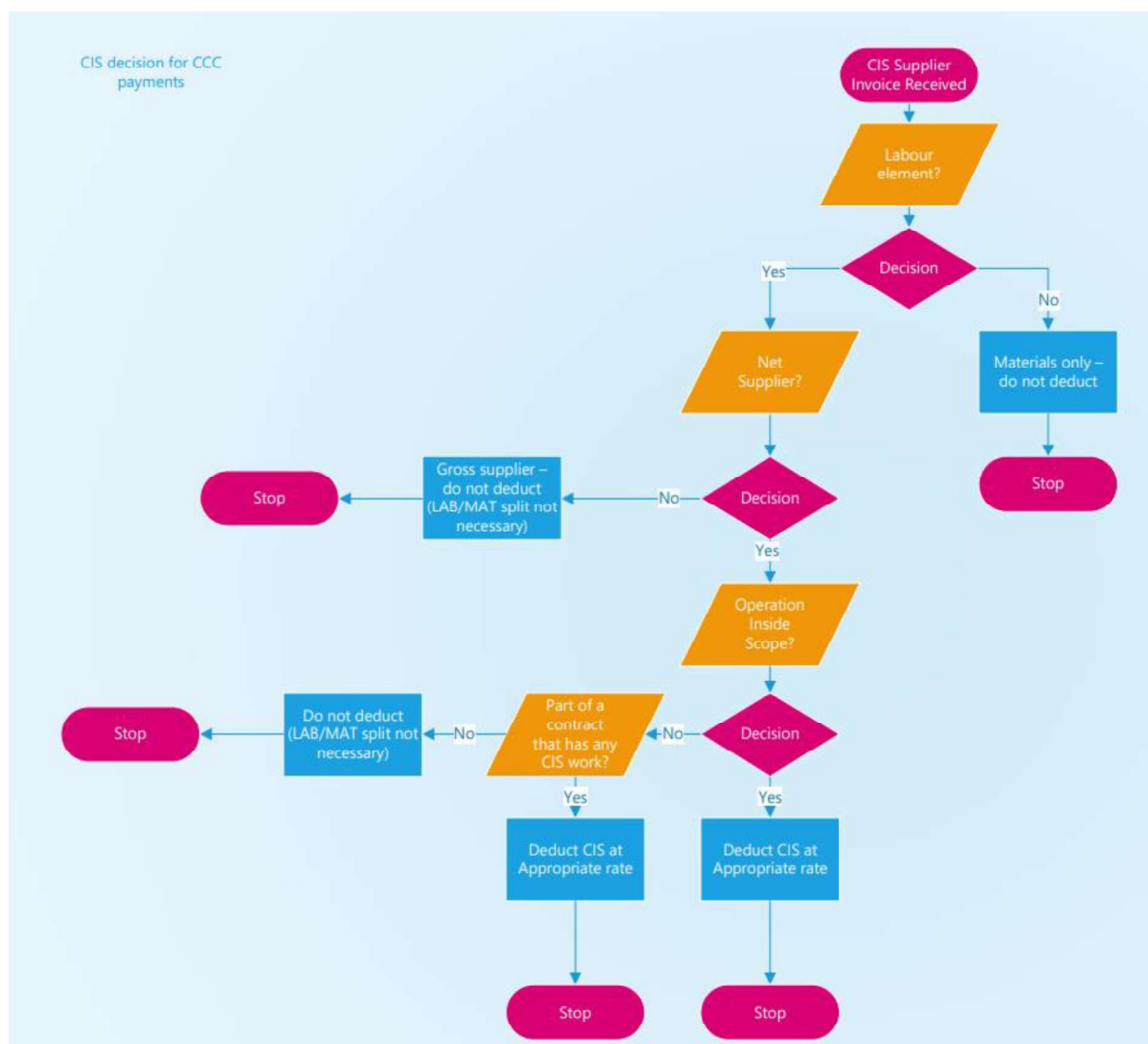
4. Calculating deductions: Labour vs Materials

Deductions are only made against the labour element of payments.

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. The plant and equipment must be 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'.

Before payment the person paying the invoice should make the following decisions:



5. Considerations for contracts and tenders

When preparing and evaluating tenders under the Construction Industry Scheme (CIS), there are several key considerations to keep in mind to ensure compliance with HMRC regulations and to manage financial and administrative responsibilities effectively. HMRC hold contractors culpable for under deducted CIS tax and 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 also be applied to the under-deducted CIS tax.

It is important to stress that deductions are not in addition to agreed payments but deductions from the agreed amount which are paid over to HMRC and count as advance payments towards the subcontractor's overall tax and National Insurance liability. There have been instances where subcontractors have incorrectly attempted to 'recharge' the deductions back to the contractor as an extra expense.

By incorporating these considerations into your tendering process, you can ensure compliance with CIS requirements, mitigate risks and manage financial implications effectively.

a. Main considerations

- **Identify Construction Activities:** Clearly define which parts of the tender involve construction activities as specified under CIS. This includes work like building, repairs, renovations, installations, and other construction-related tasks.
- **Excluded payments:** Payments for the works listed as excluded are only outside the Scheme if contracted for in isolation.
- **Invoice Splitting:** Some subcontractors may try to circumvent the Scheme by splitting the invoices between the construction and the non-construction element. If both operations are part of the same contract, all of the payment will be caught by the Scheme. In deciding whether a payment is caught by the Scheme it is important to look to the contract and not the payment in the first instance. Payments that are not for construction operations will still fall within the Scheme if construction operations form part of the overall contract. It is important therefore to determine also whether the payment stands alone or is merely one in series of instalments or other payment arrangements for a larger contract.
- **Types of Contracts:**
 - **Mixed Contracts**
Determine if the tender includes both construction and non-construction work. They include items that are caught by the Scheme and others that are not. **If any part of a mixed contract includes construction operations, or more strictly 'relates to' construction operations, then all payments under that contract are caught by the Scheme, even those payments that are wholly for non-construction work at the point that they are made.**

Examples:

Repairs to Systems: Typically, repairs to a building are within CIS, but repairs to a system, such as a heating or lighting system, are outside the scope of the scheme. However, repairs to a system can be brought into the scope of CIS under the mixed contract principles.

For example, an electrical subcontractor might have a contract for rewiring and the installation of a burglar alarm system. The former operation is caught by the Scheme and the latter is not. If both operations are part of the same contract all of the payment will be caught by the Scheme, even where the subcontractor issues separate invoices for the work carried out. In deciding whether a payment is caught by the Scheme it is important to look to the contract and not the payment in the first instance. Payments that are not for construction operations will still fall within the Scheme if construction operations form part of the overall contract. It is important therefore to determine also whether the payment stands alone or is merely one in series of instalments or other payment arrangements for a larger contract.

- Call off contracts

These are firm commitments by a contractor to buy goods or services from a subcontractor over a period of time.

Framework Agreements are often confused with Call Off contracts. In a framework agreement, a rate for services might be agreed upon, but there is no firm contract until a purchase order is placed. These orders are generally called 'Spot' contracts. A framework agreement does not have a contractual commitment to purchase goods or services, which sets it apart from a Call Off contract.

b. Verification of Subcontractors

HMRC Verification:

All subcontractors are verified by the Creditors section with HMRC before making any payments. This process determines whether they should be paid gross or with deductions.

Being registered under the CIS allows contractors to ensure compliance with tax regulations while facilitating fair practices within the construction industry. Subcontractors do not have to register, but deductions are taken from their payments at a higher rate if they're not registered.

c. Deductions and Payments

- Appropriate CIS Deduction are made (20% for registered subcontractors, 30% for unregistered) from payments to subcontractors unless they qualify for gross payment status.
- Gross Payment Status: If subcontractors have gross payment status, no deductions are required, but they must be verified and recorded.

d. Tender Pricing

- Inclusion of CIS Deductions: Factor in the impact of CIS deductions in the tender. Ensure that the bid accounts for potential cash flow impacts due to CIS withholdings.
- VAT Considerations: Ensure VAT is correctly calculated and distinguishable from CIS deductions in the tender pricing.
- Payment Terms: Clearly outline payment terms, including how and when CIS deductions will be made and reported.

e. Compliance Audits on Material Labour split

- Regular Audits: Conduct regular internal audits to ensure CIS compliance. This includes checking invoices.
- HMRC Inspections: Be prepared for potential HMRC inspections. Maintain readiness by having all relevant records organised and accessible.

f. Regulations

- Ensure all aspects of the tender and subsequent contract comply with HMRC regulations and best practices.

g. Contract Clauses

- CIS Compliance Clauses: Include specific clauses in the contract to address CIS compliance. This can include stipulations on verification, deductions, and reporting responsibilities.

Example Clause for CIS Compliance:

All payments to subcontractors for construction work under this contract will be subject to the Construction Industry Scheme (CIS) regulations. The main contractor will verify the subcontractor's status with HMRC and apply the appropriate CIS deductions unless the subcontractor is registered for gross payment status. Subcontractors are required to provide their UTR and relevant details for verification purposes. Monthly CIS returns will be submitted to HMRC, and statements of deduction will be provided to subcontractors accordingly.

Example Communication to Subcontractors:

Dear [Subcontractor],
As part of our compliance with the Construction Industry Scheme (CIS), we will be verifying your status with HMRC prior to making any payments. Depending on your registration status, deductions of 20% or 30% may be applied to your payments unless you have gross payment status. Please provide your Unique Taxpayer Reference (UTR) and other company details promptly to facilitate this process. For further information, you can refer to HMRC guidelines on CIS. [Construction Industry Scheme: a guide for contractors and subcontractors \(CIS 340\) - GOV.UK \(www.gov.uk\)](https://www.gov.uk/guidance/construction-industry-scheme-a-guide-for-contractors-and-subcontractors)