



# CONSTRUCTION INDUSTRY SCHEME (CIS) PROPOSED AMENDMENTS

## **THE INCOME TAX (CONSTRUCTION INDUSTRY SCHEME) (AMENDMENT) REGULATIONS 2024**

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**PREPARED AND SUBMITTED BY**

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## Introduction

The British Property Federation (BPF) represents the UK real estate sector, an industry that contributes more than £107bn to the economy and supports 2.3million jobs. Our members are invested in commercial and residential real estate in communities across the UK - revitalising our cities and shared spaces, re-imagining our town centres, and creating vibrant new places designed for the way we live today.

We engaged with Government's consultation last year on possible reforms to the Construction Industry Scheme (CIS) and we are supportive of the measures Government will be taking forward following this consultation to strengthen and simplify the regime, in particular:

- We recognise the merits of including VAT within the tests for Gross Payment Status (GPS) – and we are reassured that Government's intention is that minor VAT compliance failures will not result in GPS refusal or removal.
- We are pleased that the Government have recognised the detrimental cash flow impact that landlord to tenant contributions to construction works that are caught by CIS can have on tenants seeking to take out new commercial premises – and we are pleased that these regulations are seeking to address these challenges.
- While it is disappointing that Government will not be taking forward a group compliance functionality, we are pleased that Government have recognised that there is further scope for simplifications of the CIS compliance process for both HMRC and the taxpayer. We understand that officials will be considering further options for simplification as a separate workstream, and we look forward to engaging on this in due course.

### ***Improvements to the proposed regulations***

We think there is scope to improve to the proposed regulations to ensure they can apply to more typical commercial scenarios – and to remove areas of ambiguity. We set out further detail in the appendix – but would draw out the following in relation to the use of the terminology "lease agreement" within the regulations:

***"Lease agreement" should be defined*** – The regulations currently refer to construction operations as agreed within a "lease agreement". A lease negotiation will typically involve a number of separate legal documents (notably an agreement for lease and a lease, but also often capital contribution deeds, and/or side letters) - all or which may include an agreement to perform some construction operations. If the term "Lease Agreement" is used in these regulations, it should also be defined in the regulations, to make clear that the terms "Lease Agreement" would cover references to construction operations included in any of these documents. More details on these typical lease documents are included in the appendix. By aligning the terminology with that already used by landlords and tenants when engaging in lease negotiations, the regulations will be much clearer for taxpayers to apply.

We also have some concerns that the narrow drafting of the regulations will not enable all commercial payments between landlords and tenants to be removed from scope of these rules – and we would like to explore whether the rules could be more broadly drafted without weakening the ability of the CIS regime to combat fraud – including broadening the measures to include tenant to landlord payments.

We have included more detailed comments and suggested improvements to the draft regulations within the appendix - please do not hesitate to get in touch if you would like to follow up on any aspect of our response.

## Appendix: Comments on the proposed regulations

We raise some comments and suggested improvements in relation to sections of the regulations in turn – followed by some general comments.

### **1. Comments in relation to Sch 24ZA (2)** - extracted below for ease:

***“(2) The conditions prescribed in relation to the payment are that—  
(a) the payment is for construction operations(a) agreed as a consequence of a lease agreement,  
(b) there is a written contract between the tenant and the person undertaking the construction operations, and  
(c) the payment is for construction operations relating exclusively to parts of the property which the tenant occupies or will occupy under the lease agreement.”***

1.1 **In relation to (2)(a)** – it needs to be clear that the term “lease agreement” refers to documents that are typically used during a lease negotiation – in particular, the Agreement for Lease (AfL); lease contract; and capital contribution deeds and side letters. This could be achieved by including a definition of “lease agreement” within the regulations, as follows:

#### 1.2 Suggested definition of lease agreement:

*““Lease Agreement” means an agreement for lease, the lease and any other ancillary documents in connection with either of those documents.”*

#### 1.3 Typical lease documentation

A little more detail on the typical lease documents where references to construction obligations are typically included are set out below – it would also be helpful to refer to these specifically in the guidance (although note it is not necessarily an exhaustive list).

- a. **An Agreement for Lease (AfL)** – this will normally be agreed before the main lease is signed – it is an agreement to enter the legally binding lease contract once certain conditions are fulfilled (e.g. once building works have been carried out to a certain standard). There are typically quite significant financial penalties if a party reneges on an AfL (in much the same way as financial penalties would be imposed if a party backs out of buying a house after contracts have been exchanged). It is the AfL that will typically include provisions around works and is the agreement under which the specific contract payments would be made.
- b. **The lease**: this is the main legal agreement which both parties committed to sign as part of the AfL – it sets out the terms of the lease between the landlord and tenant (rent, length of tenure, responsibilities or each party etc).
- c. **Side letter** - If changes are needed to an AfL or lease – a side letter is often used to add additional agreements or obligations to the current lease contract which would be personal to that specific tenant rather than running with the land. This could be between the date of the AfL and the lease – or quite commonly, at a lease renewal date.
- d. **Capital contribution deed** - this document will often specifically stipulate the conditions that must be met in relation to works being carried out and the capital contribution towards those constructions works.

- 1.4 **In relation to (2)(b)** – requiring a written contract would require extra administration/information request from the landlord – and in some cases a tenant might not have this in place or may be reluctant to share it.
- 1.5 A landlord would typically request invoices from a tenant as proof of completion of works, or sometimes require a surveyor's report. Would either of these be sufficient to address HMRC's objective with this clause?
- 1.6 Or alternatively, it may be simpler to specify what behaviours or action HMRC are keen to avoid with this clause. For example, if HMRC are simply keen to ensure that a loophole cannot be generated if a landlord were to lease a building to a tenant whose business is the onward supply of construction services - perhaps the following wording would better target HMRC's intentions:

***Suggestions for alternative Sch 24ZA (2) "the tenant will appoint a third party to undertake the construction operations" or "the tenant isn't the end sub-contractor which is undertaking the construction operations".***

- 1.7 If HMRC are not minded to change this clause as proposed above, at the very least, we would suggest the following amendments to the existing clause, to address cases where either payment is made by the landlord to the tenant, or works start before a written contract is in place:

***"there is ("**or will be**") a (~~written~~) contract between the tenant and the person undertaking the construction operations, and"***

- 1.8 We would note that elsewhere in the guidance, the term 'contract' is intended to apply to all contracts, whether written or verbal – we would suggest that the same applies here and the term "written" is removed from the clause. Furthermore, if it is not necessary for a landlord to have sight of a written contract, this should be stipulated in the guidance.
- 1.9 **In relation to (2)(c)** - This wording is particularly narrowly drafted – and would be too narrow to apply to a lot of common construction works that are typically undertaken outside of a tenant's demise e.g. "floor boxes", or works to heating or other utilities that are external to the demise but will ultimately benefit the tenant's property. We would recommend amending this clause as follows:

***"construction operations relating to works intended primarily to benefit the tenant, as occupier of the property, or any parts of the property to be let to the Tenant under a lease agreement" (our comments on the exact definition of lease agreement also applies here - see paragraph 1.1 of this response)***

It's important that the regulations are clarified in respect of this point – it would be impossible to give taxpayers certainty on an exhaustive list of possible works that would qualify outside of the tenant's demise using only the guidance – therefore, it is particularly important that the regulations are updated for this point in order for them to achieve their stated aim.

## 2. Comments In relation to Sch 24ZA (3) - extracted below for ease:

**(3) For the purposes of this regulation—**

**(a) reference to “tenant” include, where the property is sub-let, a sub-tenant, and**

**(b) reference to “landlord” include any person who, under a lease agreement is, as between himself and the tenant, for the time being entitled to the rent payable under that agreement.”.**

2.1 These definitions may risk adding more ambiguity. There can be several landlords and tenants within a leasing arrangement (with levels of sub lessors or sub lessees). Given it would be hard to define all possible parties, it may be clearer to leave the terms “landlord” and “tenant” undefined in the regulations – and simply allow people to use their normal, commonly understood, meanings.

## 3. Other comments

3.1 **Tenant to landlord contributions** - we note that the regulations currently only cover landlord to tenant contributions for construction works. It is also common for a tenant to ask to pay a landlord to complete works on their behalf, over the course of a tenancy – particularly where the works are closely aligned to the buildings (such as fixtures/mezzanines etc). This can be an issue for larger tenants who may need to be registered as a CIS contractor (e.g. a larger retailer) – but it is also an issue if the landlord doesn't have an entity with Gross Payment Status – such as a single asset owning company. It can be incredibly difficult to recover the tax withheld in these cases, as with no GPS and no payroll function, there is no formal mechanism to recover the tax withheld.

If Government have concerns about broadening these regulations to that degree, an option would be to consider changes to the “Small payments exemption” – which allows smaller works of less than £1k to fall outside the scope of CIS, with an application process. It would be worth revisiting this exemption, to bring the threshold up to higher level, and make sure that the applications process is reviewed to ensure it is simple and easy to apply. This would at least resolve the issues for smaller payments. However, we would note that an issue will still remain for larger works, where the impact of the withhold tax on cash flow will be significant – therefore, our primary recommendation is that Government consider extending the regulations to cover tenant to landlord contributions for construction works as well.

3.2 **Commencement date** – the regulations should clarify that the commencement date refers to payments made after the commencement date (to avoid possible confusion with other dates relating to the construction contract).

3.3 **Regulation 20 should not be revoked** – we do not think that Regulation 20 should be revoked as a result of the introduction of this new regulation. Regulation 20 covers the treatment of reverse premiums and inducement payments – i.e. the treatment of landlord contributions towards tenant works (cat B works). This new regulation does not relate to the tax treatment of reverse premium and inducement payments – and therefore, Regulation 20 should not be revoked. If Regulation 20 was revoked, these payments could fall back within the scope of the CIS rules due to the mixed contract rules.