

Tackling Construction Industry Scheme Abuse



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To: CISConsultations@HMRC.Gov.UK

Introduction and background

1. The British Property Federation (BPF) represents the real estate sector – an industry which contributed more than £100bn to the economy in 2018 and supported more than 2 million jobs¹. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.
2. The nature of real estate investment means that our members will have ongoing construction costs associated with repair, maintenance and improvement works as a matter of course. In addition, when a significant renovation or development project is embarked upon, our members will typically engage a mainstream construction contractor to carry out the construction works. Therefore, our members will typically fall within the CIS rules by virtue of being a 'deemed contractor'.
3. We are supportive of government's efforts to tackle tax abuse and also to provide clarity to tax payers around how the rules should be applied in practice. We are also grateful that HMRC are consulting early on initial ideas which seek to address areas of abuse which they see within some construction supply chains. We are keen to feed in any insight that might be helpful and to provide constructive solutions to help HMRC develop a robust system which both enables tax payers to get their tax right first time and provides HMRC with timely information to clamp down on any abuse.
4. We are concerned that a number of the proposals outlined in the consultation could have adverse and unintended commercial consequences for both our members and the construction sector more broadly. We have set out these concerns in more detail in our response. We have also taken the opportunity to highlight within the appendices some options to simplify and streamline the CIS compliance process – in this regard we consider that a group compliance function would make the compliance process significantly more efficient for both taxpayers and HMRC.
5. We look forward to continuing to engage with HMRC on this matter – please do not hesitate to get in touch if you have any questions.

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¹ <https://www.bpf.org.uk/sites/default/files/resources/16688%20BPF%20Economic%20Footprint%20Report%202014.08.19.pdf>

Key recommendations

1. Deemed contractors

As the rules currently stand, moving to a monthly rolling basis to monitor construction spend across all construction contracts would place a significant administrative burden on large organisations (who may have hundreds of construction contracts ongoing at any one time). We would recommend that this proposal should be considered further in conjunction with other measures to simplify and streamline the existing compliance process – and in this regard, we would recommend the introduction of a group compliance process (outlined further in appendix 2).

2. Deductions for materials

In order to avoid significant cash flow implications for the construction sector, this policy should be reconsidered to ensure that all parties in a supply chain can claim deductions for materials where appropriate. HMRC could be better safeguarded by removing the possibility of using estimates – and thereby ensuring each party receives proof of purchase to account for the exact costs incurred.

3. Supply chain measures

As property owners, we often do not have best oversight of the entire supply chain, therefore we would advocate for an exemption for deemed contractors, similar to the ‘end user’ exemption within the domestic reverse charge rules.

4. Other suggestions to simplify the compliance process

a. Group compliance process

Many of our members submit a significant number of CIS returns each month. We believe there is scope to significantly streamline and simplify this process for both taxpayers and HMRC – and to that end, we set out further proposals in respect of a group compliance process within appendix 2.

b. Landlord tenant contributions

It is becoming increasingly common place for landlords to provide tenants with funding to set up their new business premises as they see fit – often landlords and occupiers will negotiate a fair proportion for each party to contribute. Typically the occupier will arrange and pay for the construction works – however, in many cases, this can inadvertently bring them within the CIS rules. Where they are a start-up or don't have employees on a salary yet (which is particularly common at the moment with many tech start-ups) – this can result in a significant cash flow hit companies which already have significant cash flow limitations. We would recommend that landlord to tenant payments should be excluded from CIS in the same way as they have been excluded from Domestic Reverse Charge i.e. where both parties have an interest in property.

Structure of the response:

Appendix 1: Response to consultation questions

Appendix 3: Proposals for a group compliance process

Appendix 3: Landlord/tenant contributions

Appendix 1: Consultation Questions

Chapter 3: Correcting the CIS deductions claimed on an EPS

1. Our members are not directly impacted by the proposals set out in Chapter 3, and as such, we have not responded to questions 1 to 10.

Chapter 4: Other legislative changes

Q11: Do you have other ideas that could protect the CIS from abuse?

2. We set out our comments in respect of each of the areas touched on in Chapter 4 in turn.

Deemed Contractors

3. We understand the rationale for seeking to switch from a look back test to a rolling basis – whereby a deemed contractor would be required to register with the CIS schemes once a project incurs £3m of spend on a construction contract.
4. We have a couple of reservations in respect of the proposals – in relation to the practical application and also in respect of how well the new rules will protect against fraudulent activity. We also have a related observation in relation to the de-registration process for deemed contractors.
 - 4.1. **Practical application:** Currently, some of our larger members are set up to receive 6 monthly updates on construction spend across their operations – which works well for the current ‘look back’ approach. It would involve significant additional administration to receive these updates every month – and indeed, with enough time to register with the CIS scheme before the next payment is due. We do not believe that this additional compliance obligation and necessary changes to internal reporting systems would be feasible in many cases. As such, we consider that these proposals should be reconsidered alongside other measures which could help simplify and streamline the CIS compliance process – such as via a group compliance functionality (as discussed further in appendix 3).
 - 4.2. **Fraud protection:** While we acknowledge that monitoring the threshold on a contract by contract basis could make it easier to monitor when the threshold is breached in some cases. We would be concerned that this could be easily avoided by simply splitting down the contracts into smaller (sub £3m chunks) – or even by manipulating accounting period end dates. For this reason, HMRC may want to reconsider continuing to apply to threshold to total construction spend in a given entity.
 - 4.3. **De-registration:** We note that the consultation touches on the possibility of an entity ceasing to operate CIS when construction operations cease on a project. We would note that this will be difficult in practice because for large properties, there will likely be ongoing repairs and maintenance related construction spend every month – and therefore it makes it very difficult to be able to cease operating CIS. For this reason, many of our members will have a significant number of nil returns each month. Therefore, we would advocate for the criteria for de-registering to be at the point the construction spend falls below a certain threshold, rather than ceases completely. We would also recommend the inclusion of a specific box on the CIS return, which would enable a

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deemed contractor to notify HMRC when the construction spend has reduced below the threshold, and they do not intend to operate CIS anymore.

Deductions for materials

- While we acknowledge that HMRC were seeking to clarify the appropriate process, we would like to raise concerns in respect of the potential cash flow implications for construction supply chains, should the application of the rules be applied as proposed. In particular, we do not understand the rationale for applying a different approach to members of a supply chain that purchase the materials directly or indirectly – as the economic impact is the same.
- We have included a numerical example below which illustrates the potential cash flow implications on a supply chain, (assuming no one in the chain has gross payment status). Even with the small supply chain, scenario 1 shows that there are already cash flow implications on the second subcontractor when they do not claim deductions for the cos of materials.

Scenario 1 - Cost of materials are only deductible by 1st subcontractor who buys materials direct					
	Materials	Paid to prior subcontractor (gross)	Labour/ other	WHT @20%	Received net
1st subcontractor <i>(bottom entity in the supply chain)</i>	200		50	10	240
2nd subcontractor		250	50	60	240

Scenario 2 - Cost of materials can be included throughout the supply chain					
	Materials	Other costs paid to prior subcontractor	Labour/ other	WHT @20%	Received net
1st subcontractor <i>(bottom entity in the supply chain)</i>	200		50	10	240
2nd subcontractor	200	50	50	20	280

- Scenario 2 uses the same original costs of labour and materials – but by allowing deductions for materials for both sub-contractors, the second sub-contractor receives sufficient funds to pay the first sub-contractor and the WHT, thereby alleviating the cash flow challenges.
- Economically, everyone in the chain effectively purchases the materials, therefore, by not allowing those deductions throughout the chain, some sub-contractors will begin to be taxed on their income, and not their profits – thereby creating the cash flow challenges.

9. If HMRC remain concerned around the potential for fraud in respect of claiming deductions for materials – one approach may be to require evidence or proof of the exact amount paid for materials before a deduction can be made (rather than allow estimates of the costs for materials).

Expanding the scope of the false registration penalty

10. We acknowledge the need for HMRC to crack down on this fraudulent activity. Our only reservation is that we had understood that the recent regulations around the criminal facilitation of tax evasion (CCO rules) would have captured this kind of fraudulent behaviour. It seems superfluous to introduce two similar sets of legislation – to that end, in the first instance, perhaps it would be preferable to consider how the original CCO rules could be improved to ensure they can target this type of activity effectively.

Chapter 5: Early consultation on supply chain proposals

Q12: Do you consider supply chain measures to be an appropriate response to this fraud?

11. We have set out below why we would not feel best placed in the supply chain to carry out the type of due diligence work proposed. It is not clear whether any member of the supply chain would be able to carry out these works very easily – although respondents representing main contractors may be able to provide the best insight in response to this question.

Q13: What due diligence checks do you currently undertake on your subcontractors/suppliers? Q14: When do you undertake these and why?

12. As deemed contractors, our members will typically perform extensive due diligence on the main contractor that they engage with. We also build into our contracts a formal onus or expectation that the compliance with certain rules or regulations will be carried out by the main contractor (such as the modern slavery act, and the CCO rules etc) – it may be possible to take a similar approach with these rules.

Q15: Would you consider undertaking such checks further down your supply chain? If not, why not?

13. It would be very difficult for a deemed contractor to perform due diligence on the whole supply chain. Often the main contractor does not appoint the whole supply chain at the point the contract is signed – rather different contractors and sub-contractors will be engaged in the project at various points in the project, depending on what work needs to be done and depending on which contractors have availability or resource at a given point in time. Given the flexible approach to resourcing different works – and given it is the main contractor that will negotiate contracts with underlying contractors, we do not feel able to perform extensive due diligence on the whole supply chain.
14. We would advocate for an exemption for deemed contractors from such provisions – in a similar manner to ‘end users’ being outside the scope of the new domestic reverse charge rules.

Q16: What action would you take if you were not satisfied following your due diligence checks?

15. As a general rule, our members would not engage a contractor again if something emerged from the due diligence work that they were not satisfied with. Depending on the severity of the situation, the contractor would either be permitted to finish their current job or asked to cease work immediately.

Q17: Could a site registration system work in the UK?

16. The UK construction sector is significantly larger than the Irish construction sector – and therefore it is not clear whether this approach would work as effectively in the UK.
17. However, we would support moves to introduce more automation and digitalisation of the compliance process - allowing HMRC to receive information in real time would put HMRC in a better place to detect fraud or assist tax payers with getting their tax right first time.
18. From our perspective, we would have reservations around the practical application of a site registration scheme. At present, our members will often engage the same contractor over several sites at any one time. Breaking these invoices down by site would be a challenge – and would involve significant change in internal processes for both us as deemed contractors, and for the contractors we engage with.
19. In order to be successful, the system would need to be capable of dealing with huge volumes of new construction sites and contractors on a daily basis. To that end, a site registration scheme would have to go alongside significant investment in making CIS digitalised – enabling real time responses from HMRC – particularly in respect of basic administrative functions (like registrations, deregistration etc).

Q18: How much detail is needed for these reports to be effective?

Q19: What burdens would such a process place on contractors?

20. As noted in response to question 17, it is likely that such an approach would involve significant change and upheaval of existing administrative processes of contractors – but we will defer to respondents representing contractors directly to provide better insight.

Q20: How could these burdens be mitigated?

Q21: Would these two measures encourage better supply chain due diligence processes?

Q22: Do any of these supply chain proposals merit further consideration?

Q23: Do you have other ideas that could help combat fraud in construction supply chains?

We would note that the making tax digital agenda will allow HMRC to receive more detailed and timely data on tax payers. In due course, this data could provide useful insight to enable HMRC to determine more targeted measures to address some of the avoidance they identify in the future.

Q24: What impact will the changes have on your business?

21. See our responses to questions 14 and 15 (supply chain measures) and 17 (site registration scheme).

Q25: Are there any specific impacts on small and micro businesses that are not covered in the impact assessment? If so, please provide details of the anticipated one-off and on-going costs and burdens.

22. No comment.

Q26: Do you think these proposals will have any impacts on sub-contractors not already covered? If so, please provide details.

23. No comment.

Appendix 4: Group compliance process

24. Administering the CIS scheme can consume a significant amount of staff time - one BPF member had to submit over 90 monthly CIS returns to HMRC last month, the majority of which had no withholding tax as subcontractors have gross payment status or there are not payments within the scope of CIS.
25. BPF members support the aim of CIS and would not advocate measures that could undermine efforts to tackle evasion. What BPF members would like to propose are steps to simplify the scheme to free-up resource for business and within HMRC, so officials can spend less time processing paperwork from compliant businesses, and more time tackling cases of criminal evasion. We consider that a group compliance process would help simplify and streamline the compliance process considerably. We set out further details below.

Establishing a grouping mechanism for CIS:

26. While organisations are currently able to set up grouping mechanisms for most taxes including VAT, stamp taxes and corporation tax, no such option exists under CIS and this creates large amounts of additional administration where the tax risk is minimal.
27. As a basic example, property groups will often use an internal development company to pay external suppliers for construction costs incurred by the group owning property companies. The development company will apply CIS when paying these external invoices, and then re-charge the costs to the internal property company. This is done for internal administrative reasons.
28. In the absence of a grouping mechanism this internal re-charging is also subject to the full obligations of CIS – with the property company having to verify the tax status of the development company, potentially withhold tax and report all these internal payments to HMRC.
29. Requiring these internal payments to comply with CIS effectively means the group has applied the scheme twice in respect of the same cost – this is administrative duplication and does not add to efforts to prevent evasion. To abolish this layer of bureaucracy, a basic grouping mechanism could be established to remove intra-group payments from CIS based on the following principles, derived from existing VAT grouping rules:
 - Entities or organisations would elect into group membership. The test for joining the group would be similar to VAT grouping with a 50% ownership test, subject to basic but overarching anti-avoidance provisions to prevent abuse.
 - Each entity could only be a part of one CIS registration - therefore on joining a group all its other CIS registrations would cease, immediately reducing bureaucracy for HMRC.
 - One nominated company would deal with the 'outside world' – so it makes a single CIS return to Government and would be treated (for CIS purposes) as the entity making external payments (and any deductions) to third party suppliers on behalf of group members.
 - Each member of the group would be jointly and severally liable in respect of CIS compliance liabilities.

Appendix 5: Landlord-tenant payments

30. It is becoming increasingly common place for landlords to provide tenants with funding to set up their new business premises as they see fit – often landlords and occupiers will negotiate a fair proportion for each party to contribute. Typically the occupier will arrange and pay for the construction works – however, in many cases, this can inadvertently bring them within the CIS rules. Where they are a start-up or don't have employees on a salary yet (which is particularly common at the moment with many tech start-ups) – this can result in a significant cash flow hit companies, which is particularly challenging for those businesses just starting up.
31. While landlord contributions to tenant works (Cat B) are generally considered inducements and excluded from CIS as reverse premiums, Cat A payments (landlords' contributions to tenants for landlord's works) - in HMRC's view - fall within the scheme. However, there is currently a lack of clarity on what type of building work counts as inducements and are excluded from CIS. The result is that landlords will often assume that payments to tenants will be caught by CIS – with the landlord being deemed a contractor, and the tenants in receipt of payments for construction works registering as subcontractors. Applying the CIS currently involves detailed factual analysis of the works to determine whether the payment is classified as 'reverse premium' for CIS purposes. This often represents an arbitrary threshold.
32. Registering as subcontractors can be burdensome on tenants who are usually from outside the construction industry and have had no prior reason to consider the CIS regime. In addition, new or small businesses will suffer up to 30% withholding affecting their business cash flow (sometimes for a long period of time if they don't have any employees on payroll yet). Alternatively, they will have to go through the administrative burden of registering for gross status and hoping that it is received on a timely basis. Gross status is designed for organisations within the construction sector and is not suitable for infrequent or one-off payments such as landlord contributions.
33. **We would recommend that all landlord to tenant payments should be excluded from CIS in the same way as they have been excluded from Domestic Reverse Charge i.e. where both parties have an interest in property.**
34. An alternative solution would be that a new exception is introduced along the lines of "Regulation 22". Regulation 22 is an existing exemption for "own build" works and excludes payments from CIS made by tenants in respect of works to their own premises provided the property is "used for the purposes of the business of [the tenant]". The effect of Regulation 22 is that the tenant will generally not have to apply CIS when it makes payment to its building contractor for any works carried out at the start of a new lease (regardless of the nature of the works). Our proposal would be to create a new exception that applies where a landlord contribution is made to a person who will use the landlord contribution for carrying out any works at a property to be "used for the purposes of the business" of the recipient. Unlike the existing 'reverse premium' exemption, this would not apply only to tenant's works, but instead to all types of works. The new exemption would prevent cash flow issues for tenants as tax will not be withheld.