



CONSTRUCTION INDUSTRY SCHEME REFORM

CONSULTATION RESPONSE

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 are supportive of the government's efforts to strengthen and simplify the Construction Industry Scheme (CIS). We recognise that CIS plays an important role in encouraging and facilitating tax compliance and payments within the construction sector – protecting significant tax revenues. It is right that Government should take stock of how well the tax system is addressing risks of fraud; and furthermore, consider whether there are options to simplify and streamline the compliance process, for both HMRC and taxpayers.

This consultation considers two important areas where we consider there are significant opportunities to do this:

- the treatment of landlord/tenant contributions for fit out works;
- the introduction of a group compliance functionality.

Simplifying these aspects of the CIS rules has the potential to free up significant time and resources for both HMRC and the taxpayer. Furthermore, the current challenges associated with the treatment of landlord/tenant contributions goes beyond the simply administrative – it currently imposes significant cash flow burdens on some businesses – and it is often most significant for businesses just starting up in the UK. It is particularly important that we address this issue as quickly as possible, to ensure that our tax rules are not inadvertently creating barriers to new businesses starting up in the UK.

Executive summary

This consultation has highlighted two important areas where there is scope to improve the compliance journey for taxpayers – and importantly – ensure that the measures are well targeted and impose a proportionate burden on business. We are broadly supportive of the proposals within the consultation, and we have taken the opportunity to highlight a number of other options to simplify the CIS compliance process, in response to question 20.

We would draw out the following key points:

1. **Landlord/tenant contributions should be outside the scope of CIS** – In the commercial property sector, a landlord will typically provide a property up to a certain market standard, and any fit out of the property beyond that, which is typically more tailored to the tenant's requirements, will be the responsibility of the tenant. However, where it is more efficient to do so, a landlord will often pay a contribution for their share of the fit out works directly to the tenant, who will engage their contractor to carry out both sets of fit out works.

Where these works are deemed to fall within scope of CIS, the ramifications for the tenant can be significant – particularly the cash flow implications - as, being outside of the construction sector, they will not be aware of the CIS obligations or have gross payment status, so they will suffer withholding tax on the landlord's payment for fit out works. This is particularly challenging for a non-UK business starting up, as the typical channel for obtaining a refund of the tax withheld would be through payroll taxes, which may not be established yet for a new business.

This can be a real shock, particularly for non-UK businesses coming to the UK for the first time – and a very poor initial impression of the UK tax system. Given these rules were never designed with tenants in mind and given how significant the cash flow burdens imposed by the measures are – the rules should make clear that landlord/tenant contributions are outside of the scope of CIS.

2. **Group Compliance** – Some of our members submit over a hundred CIS returns a month – typically with no or little tax due on most of the returns. A group compliance function would go a long way to minimising the number of returns required for large groups, without significantly reducing the level of information sent to HMRC. We appreciate that it may take time to assess the scope and implications of a group compliance function – and have therefore set out a number of alternative options for Government to consider in order to ensure taxpayers are not burdened with unnecessary reporting and filing obligations.
3. **Other opportunities for simplification**

We have set out a number of areas for improvement in response to questions 20 – in particular, we would draw out the opportunities to reduce the compliance time in respect of registration and deregistration, and the current requirement to submit nil returns.

Registration/deregistration

Registering new entities: One of the most challenging aspects of administration is currently registering new entities for CIS (particularly where these are non-corporate or non-UK entities – as these can't currently be registered online). It can take significant time, even months to receive confirmation of a registration – and it can be very difficult to follow up with HMRC to receive an update on a specific registration as there is no reference number provided for the registration. Given this is the first step for businesses which are trying to comply and do the right thing, this journey should be made as quick and as simple as possible.

Deregistration also presents challenges – it currently needs to be done over the phone, and members have expressed significant frustration at the amount of time spent on phone lines, and lack of certainty where no confirmation is provided by letter or message on the HMRC portal.

A possible solution for the current challenges for registration and deregistration could be to introduce online functionality to allow the entity to switch on and off the registration through an online tax portal, as and when required.

Nil returns

A significant amount of administration time is spent completing nil returns – e.g. for dormant companies, or in relation to intra group transactions, or where otherwise no WHT has been required (e.g. for a payment to an entity with GPS). It would be a significant simplification if nil returns were no longer required – and with it, a removal of the penalties associated with not filing nil returns. Unless HMRC see some value in receiving reporting on payments with no withholding tax due, we would suggest that nil returns are no longer required if tax has not been withheld – or at the very least, where no construction payments have been made.

Appendix: Responses to consultation questions

Potential reform – strengthening the GPS tests.

Question 1: What are your views on including VAT in the GPS compliance test?

1. We agree that it seems sensible to include VAT compliance in the test.

Question 2: Can you see any unintended consequences if VAT was added to the compliance test: are there barriers to submitting returns/payments in a timely manner, and could the proposal affect compliant or particular sized businesses?

2. Consideration should be given to a proportionate penalty regime for minor technical errors or late payments of VAT, particularly given new VAT points schemes for penalties. Perhaps a certain number of points incurred would trigger removal of GPS – to accommodate a number of minor breaches.

Question 3: What channels of application are preferred, and do you envisage any challenges in shifting to digital?

3. Whilst digital channels are already in place for UK companies, we have received some criticism that the process is not always consistent and can be prone to error. We would recommend a review of the digital journey for taxpayers – and furthermore, the digital channel would also need to work for all other types of entities. There are current difficulties with registering a partnership as a contractor other than by phone, for example – and also non-UK corporates currently have to register via letter – both of these would need to be addressed and accommodated by a digital compliance process.

Question 4: Are there any other changes that could be made to the scheme which would prevent abuse, while also maintaining simplicity for legitimate users?

4. We have no comments on this.

Simplifying the treatment of payments made by landlords to tenants.

Question 5: Should any landlord to tenant payment be within the scope of CIS?

5. Landlord to tenant payments should not be in scope of CIS. The tenant is rarely or never undertaking the construction work directly and only becomes involved with CIS if a landlord is a CIS Contractor. This causes cash flow issues for the tenant as the tenant is required to pay its

subcontractor the full amount - but there is withholding deducted on the contribution from the landlord. This causes cash flow challenges for any tenant in this position – but it can be particularly detrimental for a business starting up in the UK for the first time, as they may not have any payroll established yet – so they are typically not able to quickly recover any tax withheld.

6. Furthermore, not all landlords are familiar with the CIS – for example, investment funds with long term hold strategies, with little or no development activity, that fall into the CIS by virtue of being a deemed contractor due to capital contributions to tenants. For such landlords, difficulties can arise in determining whether/when a fund entity has become a deemed contractor and significant management time and costs are incurred in analysing tenant contributions to determine if the deemed contractor spend threshold has been met. This is a significant drag on time and resource for the fund and the tenant – which seems particularly wasteful given neither are the intended target of these rules.
7. We have a strong preference for rules which remove the need to apply significant judgement – as noted, tenants and landlords are rarely familiar with CIS rules, therefore rules which require significant judgment will likely take time and resource for them to work through. Therefore, we would support an approach which removed landlord/tenant payments from CIS by either following the VAT domestic reverse charge treatment (DRC), or alternatively by amending section 61 of FA 2004.

Question 6: Do all landlord to tenant payments include an inducement or encouragement element?

8. The structure of any lease incentives is dependent on the negotiations and priorities of the tenant and landlord. Currently members are seeing some rent-free periods as well as cash inducements and contributions towards Cat A payments. The latter are more common on a new or refurbished building.

Question 7: How do you identify whether a transaction includes an inducement or encouragement element?

9. The payments/incentives to the tenant will be set out in the Agreement for Lease (AfL) and possibly in a Heads of Terms before the AfL is signed.

Question 8: What are the drivers for delegating building fabric works to tenants rather than landlords arranging it themselves?

10. There are two main reasons for tenants to undertake works to the fabric of the building:
 - a. The tenant, particularly of a new building and especially an office, may be undertaking significant fit out works. If the landlord completes the building to full Cat A standard, it is likely that some of the works done and paid for by the landlord will need to be removed when the tenant does their fit out. The tenant will then need to replace the removed works.

The cost of the works by the landlord is therefore “wasted” and so the landlord will complete to “shell and core” asking the tenant to complete to Cat A standard as part of their works with the landlord contributing to the cost.

- b. On smaller units, for example a standard high street shop unit, the cost for one subcontractor to undertake all tenant and landlord works will often be less than each party contracting separately. This may be because a large retailer has a contractor with fixed rates or because of efficiencies in doing the works at the same time. The landlord will therefore ask the tenant to contract for all works and pay for their part.

Question 9: Which of the solutions suggested is preferable?

- 11. We would prefer an option which removes the need for any judgement if possible – given tenants and landlords rarely have any experience with CIS compliance. Therefore, our preferred solution would be to copy the approach for VAT DRC (domestic reverse charge) so all landlord to tenant payments are exempt, or alternatively, amending section 61 of FA 2004.
- 12. A third option which may have merit is option D – the suggestion to widen scope of Regulation 20 to treat all landlord tenant contributions as reverse premiums. This could work – although it may be complicated if a landlord does get a benefit from the works (e.g. a landlord asks for some works to their property at the same time as a tenant performs their fit out works).

Question 10: What are the advantages and disadvantages of these proposed solutions?

13. Potential solutions:

Possible solution	Pros	Cons
A. revisit distinction between CAT A and CAT B works – focussing on the underlying nature/intent of the payment	No significant pros to note.	This option would require a lot of judgement.
B. extend scope of Regulation 22 (The Income Tax (Construction Industry Scheme) Regulations 2005) to include CAT A work as own work for landlords	No significant pros to note.	Regulation 22 only applies to deemed contractors under section 59(1)(l) (i.e. those entities who are not mainstream contractors but have spent more than £3m on construction operations). However, HMRC have published guidance that suggests that a landlord who does significant construction

		works ahead of letting a property for investment purposes is actually a mainstream contractor rather than a deemed contractor. So simply extending the scope of Regulation 22 is not going to remove all payments between landlords and tenants from the scope of CIS as it will still capture payments by landlords that are not deemed contractors.
C. apply Regulation 22 to situations where tenants are carrying out CAT A and CAT B works so as to deem the tenant as having GPS in respect of any payments made by the landlord that would then benefit from Regulation 22	No significant pros to note.	This could be complicated to administer.
D. widen scope of Regulation 20 to treat all landlord tenant contributions as reverse premiums	This solution has the benefit of not requiring additional registrations/paperwork/education – so would be worthy of further consideration.	It may be complicated if a landlord does get a benefit from the works (e.g. if a landlord asks for some works to their property at the same time).
E. amend Section 61 Finance Act 2004 – Deductions on account of tax from contract payment – so as to treat landlord to tenant's payments as not being 'contract payments	This solution has the benefit of not requiring additional registrations/paperwork/education – so would be worthy of further consideration.	
F. grant automatic GPS to tenants	No significant pros to note.	This option could this give rise to potential loopholes/fraud. Would tenants still have to register? And how would

		HMRC know they are only receiving payments as tenants?
G. copy the VAT DRC treatment whereby all landlord to tenant payments would be excluded from CIS in the same way as they have been excluded from the VAT DRC, such as where both parties have an interest in property	This is a preferred option, as the DRC is already established within VAT rules so there will be some familiarity with the approach.	<p>Slight issues – recursive call between two bits of software</p> <p>If we align DRC treatment completely – would this include payments within the group (to connected intermediaries) – and tenant to landlords?</p> <p>VAT DRC is predicated on the payments being made to an ‘end user’. This is a complex issue – knowledge raising will be required.</p>
H. better education – prospective tenants should be made aware of the CAT A issue before they enter into a lease	Better education is always valuable – this could supplement another solution which better addresses the challenges.	<p>This will not resolve cash flow challenges.</p> <p>It will be nearly impossible to identify and educate all potential tenants that could be impacted by this.</p>

Question 11: Is there a risk of creating the potential for manipulation/avoidance of the scheme by the diversion of monies via tenants?

14. It depends on the solution - it's generally hard to envisage how they could be manipulated – however, we would have some concerns with option f (granting GPS to tenants automatically) – which could give rise to potential loopholes or opportunities for fraud.

Question 12: Are there groups, other than property groups, that are affected by the excessive volume of returns they are submitting to HMRC?

15. We don't have visibility outside of the property sector.

Question 13: Is a 'grouping arrangement' the best solution to the problem outlined and are there any elements which have not been set out?

16. A grouping arrangement is the simplest way to immediately reduce the number of returns filed by contractors within the same group.
17. We have suggested a number of other possible simplifications in response to question 20 which could also significantly streamline the compliance process – although they would not reduce the number of returns filed.
18. We would suggest that a grouping arrangement would be broadly comparable to a VAT grouping arrangement – in particular, it would be preferable if there were a >50% ownership or control condition, to allow for joint venture investments, which are quite common in the real estate investment sector. It is also important that the grouping arrangement be elective – and not automatically prescribed upon a group.
19. We would note that grouping arrangements are unlikely to help investment fund landlords, as fund structures typically include trusts and partnerships that would break the group – so the alternative simplification suggestions included within question 20 will still be important to consider alongside a possible group compliance function.

Question 14: What responsibility in a 'grouping arrangement' should rest exclusively with the individual companies within the group and what responsibility with the nominated company?

20. We would suggest that the company making the construction payment would be responsible for making the WHT payment, rather than there being joint and several liability among group members – notably because it can impact on ability to obtain debt finance.
21. We would suggest that the nominated company should be responsible for all the compliance, reporting and correspondence with HMRC (including changes in members, notices of changes in subby status, and so on) – although the individual companies should have the option of making the WHT payment, as this may suit different group structures depending on how they carry out their banking and payment processes.
22. We would note that the proposed grouping arrangements would not work for externally managed funds as these are not legally part of the fund manager's group. In order to allow fund managers to access the group compliance functionality, a suggestion could be that the nominated company needs to be regulated (e.g., by the FCA) to submit a consolidated return and the entities that can be included in this CIS group must report to the board of the regulated entity.

Question 15: Do you see any specific anomalies which may arise in the context of CT and VAT grouping arrangements?

23. A corporation tax style grouping arrangement, where all 75% companies automatically fall within the group, would not work well for CIS compliance. In particular, a mandatory group would risk bringing in more entities and more payments within the CIS than would otherwise fall within scope – which risks inadvertently increasing the compliance burden.
24. Our preference would be to broadly follow the VAT grouping rules – in particular, we would prefer a elective group. It would also be preferable if there were a greater than 50% ownership or control condition, to allow for joint venture investments, which are common in the real estate investment sector.

Question 16: Should the reporting of intra-group transactions be excluded on the CIS group return?

25. This would be preferable as it would simplify the reporting considerably – and it would be in line with the treatment of intra group VAT payments.

Question 17: Will establishing a ‘grouping arrangement’ impact on third party software providers?

26. Yes, it is likely to impact on third party software providers – although we are not best placed to feed into the technical detail on the software implications. We would note that if the scheme is elective (as we suggest it should be), the software implications should not hold back the roll out of the legislation – as businesses will only elect in once they have the capability to comply.

Question 18: Should the process of a ‘grouping arrangement’ be statutorily prescribed by HMRC, and if so, to what extent?

27. The rules for setting up a CIS group should be clearly prescribed in legislation – but whether or not a group chooses to form a CIS group should be elective.
28. Some difficulties of mandatory grouping are set out below:
- a. It could hamper a company’s ability to obtain debt financing – as some lenders often struggle to get comfortable lending to a company in a group with joint and severable liability.
 - b. Business units use different finance systems, and this complicates the collection of data by one nominated company.
 - c. Business units either submit via the HMRC portal or pay for specialist software, it is not consistent across a large group.

- d. Taxpayers do not always want to include acquired companies into groups depending on the compliance history or the future intention with the company (e.g. if a company plans to move the asset out and liquidate the company, it could be beneficial to keep the company outside the CIS group).
- e. Mandatory grouping could cause particular issues in fund structures, as parts of the fund that include corporate entities would be grouped but other parts with trusts and partnerships would not be. This would make it very complex to manage CIS compliance with the fund.

Question 19: Are there any other issues you think will need to be considered?

- 29. A couple of additional points to note in relation to a potential grouping arrangement:
 - a. It would be really helpful if businesses could add/remove members of groups digitally – in a similar way to the VAT digital offering.
 - b. CIS also applies to non-corporate entities (such as partnerships and unit trusts) which are common in property funds and so these should be capable of being grouped – and similarly, intra group transactions between them should be ignored if that is the policy with corporates.

Question 20: Are there areas of the CIS in terms of its scope and or administration where simplifications or improvements could be made?

- 30. Yes, there are a number of other areas within CIS compliance which are particularly time consuming and where there is scope to significantly reduce the administrative burden on business. We set out a little more detail on the current challenges and possible solutions in turn below – but in general, we would note that there is a significant opportunity to make the compliance process much quicker and more efficient through digitalising more of the compliance journey.

Registration/deregistration

- 31. **Registering new entities:** One of the most challenging aspect of administration is currently registering new entities for CIS (particularly where these are non-corporate or non-UK entities – as these can't currently be done online). It can take significant time, even months to receive confirmation of a registration – and it can be very difficult to follow up with HMRC to receive an update on a specific registration as there is no reference number provided for the registration. Given this is the first step for businesses which are trying to comply and do the right thing, this journey should be made quick and simple.
- 32. **Deregistration** also presents challenges – it currently needs to be done on the phone – or even via letter in the case of non-UK corporate entities. Members have expressed significant frustration at the amount of time spent on phone lines and the lack of certainty where no confirmation is provided by letter or message on the HMRC portal.

Solution? A possible solution for the current challenges for registration and deregistration could be to **introduce online functionality to allow the entity to switch on and off the registration through an online tax portal**, as and when required.

Gross Payment Status (GPS) compliance test:

33. Registering as a sub-contractor for GPS can take time – given how critical this status is to the cash flow of typically low margin businesses, it is crucial that HMRC review this process and pursue options to expedite it.
34. One of the time-consuming aspects mentioned by members is the requirement to obtain very sensitive information on the directors (e.g. date of birth, home address etc) – there are lots of GDPR constraints and directors themselves are nervous about even emailing the information in some cases.
35. **We would suggest that simply requesting the names of directors should be sufficient** for HMRC to perform some checks and cross reference with Companies House data. It's not clear why further sensitive data is required by HMRC – and given the data is highly sensitive, we would suggest that HMRC should have the ability to request it on a case-by-case basis, when they have a justification for requiring it.

36. Other comments on the GPS tests:

Turnover test:

- a. Gross payment status subcontractor groups – the current exemption of the turnover test for a subsidiary of a GPS registered parent company does not reflect how property developers are typically setup. We would suggest that **the exemption should be broadened to include 'sister companies'** or otherwise streamlined if there are a number of members of the group which already have GPS status.
- b. Consideration should be given as to whether **the turnover test should be removed altogether**, as the amount of income does not determine compliance. Compliance checks are already carried out for these purposes.

Bank account test

- c. This is difficult for groups with a single bank account for their whole groups. It can also take significant time to set up a bank account. **Could businesses be given the option to provide alternative evidence to prove they are in business?**

Nil returns

37. A significant amount of administration time is spent completing nil returns – e.g. for dormant companies, or in relation to intra group transactions, or where otherwise no WHT has been required (e.g. for a payment to an entity with GPS).
38. It would be a significant simplification if nil returns were no longer required – and with it, a removal of the penalties associated with not filing nil returns.
39. Unless HMRC see some value in receiving reporting on payments with no withholding tax due, **we suggest that nil returns are no longer required where no tax is withheld** – or at the very least, where no construction payments have been made.

40. *'Period of inactivity' rules*

41. The rules allow for companies to notify HMRC if they are expecting a period of inactivity, which allows them to not file a return for 6 months. This can just create an additional deadline to manage, and some companies would rather keep filing nil returns to avoid risking missing the 6-month deadline to re-notify HMRC that they remain inactive.
42. Simply no longer requiring nil returns would resolve the administration associated with inactive companies. However, if Government do not decide to pursue this policy, we would suggest that companies can notify HMRC that they will be inactive for a period, but they would only be required to 're-activate' their CIS returns when they are active again (which is more in line with other taxes).

Digitalisation

We are fully supportive of HMRC pursuing efficiencies and simplifications through digitalisation. In particular, we would draw out that the following entities currently don't have the ability to register digitally:

- Non corporate entities
- Non-UK entities

Therefore, as part of HMRC's review of the digital offering for CIS, the functionality needs to be added to allow these entities to register digitally. In the meantime, the existing means of communications with HMRC (i.e. via mail and phone calls) should remain open.