



## FINANCE (NO.2) BILL 2019-21 CLAUSE 30 AND SCHEDULE 6 (CONSTRUCTION INDUSTRY SCHEME)

Issued 12 April 2021

Text of ICAEW briefing for MPs on **Finance (No.2) Bill 2019-21** Clause 30 and Schedule 6 Construction Industry Scheme published by government on 11 March 2021.

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## EXECUTIVE SUMMARY

1. The changes are being given effect through the Finance Bill with the off-set changes largely through secondary legislation. The changes came into effect on 6 April but the guidance that HMRC has published raises more questions than answers. It is now too late for businesses to plan and software developers to make necessary changes in advance of implementation date.
2. As we are now past the implementation date with no comprehensive guidance, we recommend deferring commencement until April 2022 to give businesses time to prepare, as was done with the VAT reverse charge changes.
3. Of particular concern are the proposals for materials which if implemented will not only reduce cash flow for contractors who do not hold gross payment status but also result in there being insufficient cash to pay sub-contractors amounts that they are owed. We recommend that the paragraph introducing this be deleted.
4. We urge Parliament to ensure that this legislation – and the regulations and guidance etc. – comply with our Ten Tenets for a Better Tax System, reproduced in Appendix [1], by which we benchmark the tax system and changes to it.

## THE MEASURE

5. The following four changes are being made to the construction industry scheme (CIS) rules:
  - The deemed contractor rules are being changed to prevent manipulation of the current rules so that a business cannot deliberately avoid operating CIS;
  - The cost of materials provisions are being changed to remove the ability for materials to be taken into account by more than one contractor;
  - A new power is being introduced to allow HMRC to amend certain CIS set-off claims, to prevent contractors incorrectly reducing their employer liabilities, and
  - The penalty for providing false information at registration for the CIS is being expanded to allow HMRC to charge a penalty on those facilitating such applications.
6. These measures came into effect on 6 April 2021.
7. Some of the provisions will be in secondary legislation.

## DETAILED COMMENTS

### CONTRACTORS

#### Para 2: amendments to s59 FA 2004

Sub-paras 2(2) & (3): Amended s59(1)(l) and s59(2)

8. Both subsections use the words 'at any time if, in the period of one year ending with that time'. A rolling daily 12-month look-back test with immediate need for compliance from the day after the threshold is exceeded is extremely onerous for businesses to comply with, as it would require a daily running total of expenditure to be kept. This seems excessive.
9. We therefore urge the government to consider a less frequent review requirement (eg, 6-monthly) with a requirement to start operating the CIS after a reasonable preparation period (eg, 3 months) after the threshold is exceeded.

#### Suggested amendments submitted 14.4.21

Schedule 6, Page 120, Line 25, leave out 'with' and insert 'six months before'

Schedule 6, Page 120, Line 30, leave out 'with' and insert 'six months before'

### **Sub-para 2(3): Amended s59(3)**

#### **Construction operations**

10. The phrase 'is not expected to make any further expenditure on construction operations' needs clarification.
11. Deemed contractors are often large businesses and the definition of 'construction operations' is very wide and can include insignificant works such as minor decoration. If even such minor construction works would preclude an 'election' under this section because it would be unreasonable not to except such minor on-going ad-hoc works, it appears impractical.
12. We instead favour wording such as '...if a person is not expected to incur more than £3m in the next 12 months on construction operations...'. Alternatively, a de minimis threshold could apply.

#### **Suggested amendments submitted 14.4.21**

Schedule 6, Page 120, Line 35, leave out 'any further'

Schedule 6, Page 120, Line 36, insert after 'operations' and before '.' -- 'exceeding £3,000,000'

#### **Election**

13. The legislation is unclear as to how a contractor would 'elect' for the condition to be no longer met.
14. We consider that the election should be an explicit act by a deemed contractor.

### **Sub-para 2(3): New s59(3A)**

#### **Opting in**

15. We appreciate the ability for contractors to continue operating the CIS where they chose to do so. However, there will also be businesses who have not yet exceeded the thresholds and who would prefer for operational reasons to opt in to the CIS before they are obliged to do so by statute (e.g., because of concerns of the length of time it may take HMRC to process a CIS registration, particularly for offshore entities). It appears this is not possible under the legislation as drafted.
16. We suggest any business undertaking construction operations should be able to elect to operate the CIS, not just those who once exceeded the threshold.

#### **Election**

17. As above, the draft legislation is unclear as to how a contractor would 'elect' for the condition to be no longer met.
18. We consider that the election should be an explicit act by a deemed contractor.

#### **Leaving CIS**

19. In addition, the draft legislation seems to imply that once a contractor has elected to continue to operate the CIS after they no longer exceeded the threshold, the only way to then exit the CIS is if the business was 'not expected to make any further expenditure on construction operations.'
20. In line with our comments regarding amended s59(3), this would appear to capture all construction operations, including very minor expenditure.

21. Again we therefore favour different wording such as ‘...if a person is not expected to incur more than £3m in the next 12 months on construction operations...’. Alternatively, a de minimis threshold could apply.

#### **Suggested amendments submitted 14.4.21**

Schedule 6, Page 121, Line 1, leave out ‘ceases to be’ and insert ‘is not’

Schedule 6, Page 121, Line 2, insert after ‘at any time’ and before ‘the body’ -- ‘, but the body or person expects it to be met at any time,’

Schedule 6, Page 121, Line 3, leave out ‘continuing to be’ and insert ‘being’

Schedule 6, Page 121, Line 4, leave out ‘any further’

Schedule 6, Page 121, Line 5, insert after ‘operations’ and before ‘.’ -- ‘exceeding £3,000,000’

#### **Para 3(1) – Contractors – Transitional provisions**

22. We do not understand the policy rationale for the legislation making provision for businesses who fall within the current definition, but who would not fall under the new definition of ‘deemed contractor’, to be drawn into the new regime for CIS from 6 April 2021. It is clearly the intention to change the definition so that in future, the definition will be based on a 12-month look-back test of £3m. We would welcome clarification of why the draft legislation provides for businesses which do not fall under this definition to be kept in the CIS.
23. It also appears that for businesses in this situation, the draft legislation does not provide for an appropriate exit point. The only exit route permitted by the draft legislation is when the business ‘is not expected to make any further expenditure on construction operations’.
24. It is unclear what this means, but it would seem to include any CIS expenditure however minimal, so that only deemed contractors anticipating absolutely no relevant expenditure would be in a position to de-register.
25. The draft legislation thus leads to an absurd result. For example, a business that spent an average of £2.1m per annum on construction operations in the past but after 6 April 2021 undertakes no more construction except for minor expenditure, for example £1,000pa on decoration, would have to keep operating the scheme indefinitely. In contrast, a business that did not exceed the threshold previously but then spent £2.9m on construction operations every year would not be considered a deemed contractor.
26. We therefore strongly advocate either removing this transitional clause altogether or providing an alternative exit clause. This could, for example, allow such deemed contractors to apply the normal look-back test after an initial 12 months in the scheme (i.e., from 6 April 2022).

#### **Suggested amendment**

27. Finance Bill page 121, line 8, delete paragraph 3.

### **DEDUCTIONS FOR MATERIALS**

#### **Para 4: Amendments to s61(1) FA 2004**

28. We reiterate our concerns about the proposals for materials, expressed in our response to HMRC’s consultation (ICAEW REP 57/20 at paras 29-31 reproduced below).

*29 The proposals in paras 4.11-4.12 are not realistic. Consider the following example, assume a chain of contractors A to E. Contractor E buys the materials. Under the new rules, only E would be able to take account of the cost of these materials. However, in real life, E buys the materials and D reimburses E, C*

*reimburses D and so on up the chain until the ultimate client A bears the cost by reimbursing B. If the cost of materials could not be taken into account, E would not get paid for the materials it has bought.*

*30 We hope this demonstrates that the proposed change to the rules to remove the ability to take account of the cost of materials when paying down the chain would not only reduce cash flow for contractors who do not hold gross payment status but also result in there being insufficient cash to pay sub-contractors the amounts that they are owed for materials.*

*31 We therefore recommend that this proposal is withdrawn.*

29. As noted above, we recommend that this provision is deleted, but, if these changes are implemented, further clarification is needed as to how the phrase 'direct cost' is to be interpreted.

### **Suggested amendment**

30. Finance Bill page 121, line 20, delete paragraph 4.

### **GRACE PERIOD**

#### **Para 5: New s61(4-7)**

31. We welcome that the legislation allows for a period of grace to be agreed by HMRC so a business can be given some time to set up its administration of the CIS once the threshold is exceeded.
32. However, there are several issues with this provision:
- 32.1. Currently, taxpayers can rely on published HMRC guidance and have a reasonable expectation that the period of grace will apply to them. In future, no such reasonable expectation will apply, and it will be entirely at HMRC's discretion to grant a period of grace and how long this period will be. As such the new statutory provision is narrower than HMRC's current guidance.
- We feel that the legislation should reflect HMRC's current approach per guidance.
- 32.2. There appears to be no right of appeal where a notice for a period of grace is not granted by HMRC.
- We consider that a right of appeal is essential here.
- 32.3. The legislation appears to only allow a notice to exempt a deemed contractor from their obligations to 'deduct sums from contract payments', but not to exempt a contractor from other obligations, such as registration and reporting obligations under the CIS.
- We urge Parliament to amend the draft legislation in this respect such that a contractor is relieved of all their CIS obligations.
33. To make administration more manageable in practice and give certainty to businesses, we recommend that the legislation should instead allow an automatic period of grace, eg, of three months from the date the threshold is exceeded.

### **Suggested amendments submitted 14.4.21**

Schedule 6, Page 121, Line 25, insert immediately after 'Subsection' and before '(5)' -- 's(4A) and '

Schedule 6, Page 121, Line 25, leave out 'applies' and insert 'apply'

Schedule 6, Page 121, Line 27, insert new clause 4A -- '(4A) The contractor is exempt from the requirement to deduct sums from contract payments under subsection (1) for a period not exceeding 90 days.'

Schedule 6, Page 121, Line 29 insert after '(a)' and before 'exempt' -- 'further '

Schedule 6, Page 121, Line 35 insert after 'notice,' and before 'or' -- ' but after the period in subsection (4A) '

Schedule 6, Page 121, Line 37 insert after 'notice' and before '.' -- ' but after the period in subsection (4A) '

## **RESTRICTIONS ON SET OFF – POWER TO MAKE REGULATIONS**

### **Para 6: new s62(3A)-(3C) FA 2004**

34. We also recommend that, in updating the regulations, the opportunity should have been taken to update Regulation 20 to allow offset against Class 1A NIC on termination payments that now apply and the apprenticeship levy.
35. There seems to be no obvious reason from a policy perspective as to why an offset against all employer liabilities, including these two elements, should not apply. We would hope that that this is an unintentional lacuna arising from the CIS legislation having not been updated to take account of recent changes.
36. Additionally, in introducing these new set-off provisions, we think it is important and appropriate that Parliament legislates the concessionary treatment in HMRC's guidance at CISR72080 concerning repayments made between a sub-contractor and a contractor to ensure sub-contractors are always able to rely on the position, ie, a repayment of a CIS deduction that should have been suffered by a sub-contractor to a contractor should be formally recognised as a deduction under statute.
37. Without a formal legislative basis for CISR72080, there is a risk that HMRC may refuse to apply its guidance and also seek to prevent a sub-contractor from offsetting other CIS deductions suffered against their PAYE liabilities under any new set-off regime.

## **PENALTIES**

### **Para 7: Amended s72 FA2004**

#### **Amended s72(3) & (4)**

38. The phrase 'person who exercises influence or control' requires clarification. 'Control' is an established concept in tax legislation, but 'influence' is less clear.
39. At the very least, HMRC will need to issue clear guidance on whether professional advisers would be considered as exercising 'influence' over clients in the normal course of business.

## **COMMENCEMENT**

### **Para 8**

40. As noted above in paras 1-2 Executive Summary, the changes are being given effect through the Finance Bill with the offset changes largely through secondary legislation. The changes came into effect on 6 April but HMRC has not yet published adequate guidance.
41. It is now too late for businesses to plan and software developers to make necessary changes in advance of implementation date.
42. The commencement date for the VAT reverse charge changes was delayed to give businesses time to prepare and we feel that a similar approach is needed here.
43. As such we recommend deferring commencement until April 2022.

### **Suggested amendment**

44. Finance Bill page 123, line 17, for '2021-22' substitute '2022-23'

and

Finance Bill page 123, line 20, for '2021' substitute '2022'.

## **FURTHER INFORMATION**

As part of our Royal Charter, we have a duty to inform policy in the public interest



## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).