



CONSTRUCTION INDUSTRY SCHEME REFORM

Issued 10 July 2023

ICAEW welcomes the opportunity to comment on the Construction Industry Scheme reform consultation published by HMRC on 27 April 2023, a copy of which is available from this [link](#).

For questions on this response please contact ICAEW's Tax Faculty at taxfac@icaew.com quoting ICAEW REP 65/23.

The proposal to make contractors and sub-contractors pass a VAT compliance test to qualify for construction industry scheme (CIS) gross payment status (GPS) should be dropped because it will increase burdens for the compliant majority but is unlikely to deter the organised criminal groups (OCG) that are HMRC's intended target.

The consultation document says that 15 out of 16 entities are VAT non-compliant owing to submitting returns and/or paying late. HMRC should reach out and help these entities to comply and assess whether recent changes to the VAT penalty regime are improving compliance behaviour.

We welcome the proposals to:

- exclude from CIS landlord to tenant (Category A) payments so they align with Category B payments that are already outside CIS, and
- introduce a CIS grouping arrangement.

Both changes, if carefully implemented, should simplify compliance and reduce burdens on participating parties.

This response of 10 July 2023 has been prepared by ICAEW Tax Faculty. Internationally recognised as a source of expertise, ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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KEY POINTS

1. Making contractors and sub-contractors pass a VAT compliance test to qualify for construction industry scheme (CIS) gross payment status (GPS) will increase burdens for the compliant majority but is unlikely to deter the organised criminal groups (OCG) that are HMRC's intended target. This proposal should be dropped.
2. HMRC's consultation document says that the proportion of entities (15 out of 16) that are VAT non-compliant would fail a GPS compliance test on the basis that they submit returns and/or pay late. HMRC should reach out and help these entities to comply. We would also note that the VAT penalty regime has recently changed and suggest that HMRC assesses whether this is improving compliance.
3. We welcome the proposals to:
 - exclude from CIS landlord to tenant (Category A) payments so they align with Category B payments, which are already outside CIS; and
 - introduce a CIS grouping arrangement.
 If carefully implemented, both changes should simplify compliance and reduce burdens on participating parties.

GENERAL COMMENTS

4. The main proposal in the consultation document is to make qualification for construction industry scheme (CIS) gross payment status (GPS) more stringent by adding a VAT compliance test.
5. In majority of cases, subcontracting is undertaken for sound commercial and logistical reasons. If a tiny minority of businesses is 'gaming the system' to break the rules, then more and better compliance activity and checking by HMRC is needed, rather than yet more new CIS tests that will add burdens to the compliant majority.
6. The consultation document says that 15 out of 16 of those targeted are VAT non-compliant owing to late returns and payments. We suggest that HMRC should reach out to help those entities, whose identities will be apparent from HMRC's records, to meet their VAT obligations timeously. We suggest also that HMRC needs to assess the extent to which the new VAT penalty regime improves compliance.
7. We also question whether the proposal to add a VAT compliance test would comply with Tenet 5 *Properly Targeted* of our *Ten Tenets for a Better Tax System* by which we benchmark the tax system and changes to it (summarised in Appendix 1): '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.'
8. Turning to CIS as a whole, we also note that the Background part of the Introduction uses the phrase 'workers who are frequently paid in cash'. This may have been true in 1971 but we question the extent to which workers are in paid in cash in 2023. Given that an IPSOS MORI survey in 2010 found that a very low percentage of payments were made in cash, which has decreased in the years since, we would welcome clarification of the extent to which cash payments continue to justify the construction industry scheme (CIS), and the extent to which cash payments in the construction sector contribute to the tax gap.
9. We welcome the other proposals in the consultation, namely to exclude from CIS landlord to tenant (Category A) payments so they align with Category B payments, which are already outside CIS, and to introduce a CIS grouping arrangement. Both changes, if carefully implemented, should simplify compliance, reduce burdens on relevant parties and help CIS

better comply with our *Ten Tenets for a Better Tax System* Tenets 2: *Simple* and 3: *Easy to collect and calculate* (summarised in Appendix 1).

10. We would mention the proposals for site registration and supply chain reporting put forward in the 2020 CIS consultation. If implemented these would have been unwieldy and burdensome. The fact that these ideas have not been taken forward is welcome.

ANSWERS TO SPECIFIC QUESTIONS

Chapter 3: The gross payment status (GPS) tests

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

11. The consultation document suggests that non-compliant sub-contractor entities are being set up intentionally by 'organised crime groups' (OCG) so they can be paid by the OCG as part of a long supply chain. The non-compliant entity presumably then fails to account to CIS before paying anyone lower in the supply chain via a different method (or just pays them gross).
12. The consultation document says in Chapter 3 under Potential Solutions that in about 16% of cases GPS could be withdrawn due to VAT non-compliance. It then says that in most other cases, (ie, 15/16th of cases), it would not actually need to be withdrawn if the entities stuck more rigidly to their VAT filing and payment deadlines.
13. We would note that the VAT penalty regime has recently changed. We believe that HMRC needs to assess the extent to which VAT compliance improves as a result of these changes before introducing more CIS GPS checks, which are likely to increase registration delays because different parts of HMRC will need to be involved.
14. As previously advised to HMRC, the type of businesses within the construction industry where fraud is most likely to occur are labour-only agencies. Restricting GPS to businesses other than agencies or gangmasters may be a more effective approach to tackling fraud in construction. It does not make sense to change the GPS tests for everyone to cover 1% of the industry population, or barely 1,000 businesses.
15. We recommend that HMRC uses data from its own systems, (eg, contractor monthly returns), to identify these businesses more quickly, rather than passing the burden to, and imposing additional obstacles and costs on, the compliant majority.
16. In addition, HMRC's employment specialists should be monitoring whether CIS contractors and subcontractors are genuine by ascertaining whether they undertake building activities. This could involve both desk-top checks (eg, review the activity note in statutory accounts directors' reports) and site visits and checks (eg, do the contractors/sub-contractors actually have workers in hard hats on building sites?).
17. The point is that the truly non-compliant businesses are contriving their applications for GPS in some way to make it look like they qualify, after which they quickly fold and/ or become non-compliant. Afterwards, the same people may presumably set up a new phoenix company which likewise applies for GPS.
18. What are the traits of such applicants? Is it, for example, that they have no true record of CIS compliance or of working in the CIS? Could not the GPS qualification process be more robust without disqualifying legitimate businesses? If the concern is not to exclude other genuine cases, for example new overseas entities who may have little evidence of UK compliance, from applying for GPS, perhaps different tests could be considered for such businesses that makes it harder for non-compliant 'shell companies' etc, to qualify, but still allows most legitimate businesses to qualify.
19. If it is true that supposedly non-compliant businesses funded by OCGs are deliberately breaking the rules, is it really likely that having also to contrive an apparently satisfactory VAT compliance record before applying for GPS will put them off?

20. In the majority of cases, subcontracting is undertaken for sound commercial and logistical reasons. If certain businesses are 'gaming the system' to break the rules, then more and better HMRC compliance activity is needed.
21. Any VAT compliance test that is introduced as part of GPS qualification should be very light touch. We should welcome clarification of how, and to what extent, requiring VAT compliance is expected to improve the position in relation to these non-compliant businesses, especially given that effectively, for all other CIS purposes, VAT is currently disregarded.
22. If the proposals are implemented, safeguards will need to be put in place to ensure that businesses that are not required to be registered for VAT (eg, turnover below the VAT registration threshold), are not unintentionally precluded from obtaining GPS.
23. A right of appeal is needed for entities that are not granted GPS on the grounds of VAT non-compliance.
24. VAT has a system of automatic penalty points for late compliance which could be adapted for CIS GPS.

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?

25. As noted above, it will be necessary to manage potential issues for smaller businesses who are not obliged to be VAT registered to ensure that they are not precluded from obtaining GPS, and also to not add unnecessary delay and complexity to applications while the VAT return and payment status is examined or traced.
26. The proposal to test compliance within six months of granting GPS to a business is understandable but needs to be handled with discretion. A growing business is more likely to make mistakes in its early months and there is a danger that they could be prejudiced when with more time they will improve. It might be better to extend this to at least a year.

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

27. All channels of application are required as there is a need to accommodate those that cannot use digital methods, to ensure that they are not penalised. In addition, as the practicalities of the way the industry works does not necessarily lend itself to digital, paper and other channels of application will still be needed.
28. Whether applications are made on paper or digitally, they need to be processed in a timely manner. The current application process is very time consuming as HMRC is slow in processing applications or providing updates where there is an issue with an application or the department requires further or better information. Members report that numerous applicants have experienced cash flow issues because of HMRC's processing delays.
29. The CIS helpline should be able to contact the teams processing applications to provide updates on request and provide a means of contacting the processing team. Where there are issues that need to be resolved before an application can be approved, HMRC's processing teams should quickly contact applicants to resolve queries and thereby ensure GPS can be issued on a timely basis.

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?

30. As noted above, the delays in respect of contractor and subcontractor registrations need to be addressed.
31. We suggest that arrangements are implemented to enable applicants/ owners who hold say 25% or more of the business to be identified by reference to the production of a passport and/or driving licence records.

32. We also recommend that consideration be given to making the following policy improvements:
- a. Clarifying and simplifying the transition of a property developer to becoming a mainstream contractor as opposed to a deemed contractor.
 - b. The exemption under reg 22, Income Tax (Construction Industry Scheme) Regulations 2005, SI 2005/2045, *Payments in respect of property used for business*, which provides that a payment under a construction contract is not a contract payment, should apply where a property is being used for the purposes of a group of companies and one of the entities within the group carries out all development/maintenance works.
 - c. The interpretation of what should be regarded as 'incidental' under reg 22, SI 2005/2045 should be expanded to include rental income that is not significant to the business. We suggest that a threshold of 5% would be appropriate.

Chapter 4: Administrative easements

Payments from landlords to tenants

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

33. Throughout the operation of CIS, HMRC has maintained the view that it is not the department's intention to bring the everyday workings of landlords within the operation of the scheme, such that the landlord represents a contractor.
34. We note that in this section HMRC does not appear to be especially concerned about non-compliant businesses. Both payer and payee are likely to be tax compliant and see CIS as an unnecessary burden. Most landlords and tenants are non-construction businesses and therefore the CIS burden should be as low as possible.
35. In the overall realm of the operations of landlords, payments by landlords to tenants represent a very small area of the activity of landlords.
36. We therefore believe that no landlord to tenant payment should be within the scope of CIS.
37. Excluding landlord to tenant payments will create certainty and simplify compliance and prevent the unintended consequences of tenants who use the property in their business falling within the scope of CIS.
38. We therefore favour all such payments (Category A and Category B) being CIS-excluded.

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

39. No, not all landlord to tenant payments include an inducement or encouragement element.

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

40. An inducement or encouragement element would be evident in the lease agreement or development finance agreement signed by both parties.

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

41. The main driver for delegation is to ease administration. In most cases the works are related to the commercial needs of the tenant to make the building fit for their purpose, rather than for CIS or development reasons. Delegation helps to ensure that the building works are based on the tenant's specifications and needs.

Question 9: Which of the solutions suggested is preferable?

42. As there is acknowledged confusion over whether a payment falls within or out of the scope of CIS, we recommend that Category A payments be exempted from CIS, like Category B are already.
43. There has been no impact assessment made to quantify the loss of tax arising from the non-deduction of tax from tenants; indeed, the consultation document rightly points out the problems arising from such deductions.

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

44. The advantages are simplified compliance and reductions in unnecessary administrative burdens and reporting.
45. We cannot see any significant risk or disadvantage associated with exempting both types of payment.

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

46. While there is always a risk that schemes to exploit any easement or exemption could be marketed, we believe that in this context, any exploitation would not be significant.

Reducing the administrative impacts on certain groups of operating CIS

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

47. Members report that sectors affected include manufacturing companies and large corporates, and businesses in the leisure industry, (eg, golf courses).

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

48. Yes, a grouping arrangement would be welcome. It would be ideal for groups of companies if the nominated entity were allowed to file a single return of behalf of the group. Restricting it only to companies that have GPS is unfair as there be will companies that, based on the CIS regulations, are obliged to register as a contractor.

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?

49. All statutory responsibilities should stay with the individual companies with the ability to delegate all administration and returns to the nominee.

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

50. No.

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

51. Yes – this should help to simplify administration.

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

52. Yes, provided that sufficient notice is given of the start date of any new process and legislation is passed in good time. This should provide software developers with sufficient time to ensure that their software complies. We normally recommend 18 months to enable software houses to design, build, test and install new IT applications and for users to be trained.

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

53. Yes, in terms of formalising the administrative easements and making clear the legal obligations that exist on the nominee and each entity in the group, as this will provide clarity and ensure that there is a legislative benchmark by which the arrangements operate.

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

54. Please see our answer to Question 4.

Further simplification of the CIS

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

55. We consider that a clear definition of the level of activity and/ or expenditure incurred by a property investor to make it a property developer is needed. Existing guidance is vague, open to interpretation and the examples are not relevant to many circumstances.
56. As to administration, as mentioned above, HMRC delays with contractor and sub-contractor registrations need to be addressed.
57. For other recommendations, please see our answer to Question 4.

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>).