

A QUICK GUIDE TO THE 2007 CIS SCHEME

February 2007

THE NEW CONSTRUCTION INDUSTRY SCHEME IN BRIEF

The new CIS scheme comes in from April 2007. The principle changes to the existing scheme are

- **No CIS cards**

Gone are CIS 4, CIS 5 and CIS 6 – instead of checking cards, you will now verify gross / net payment status with HM Revenue and Customs via internet or telephone

- **No vouchers**

Gone are CIS 23, CIS 24 and CIS 25 – for gross payments there are no documentation requirements, for net payments a statement of deductions must be issued by the 19th of each month for the previous tax month (up to the 5th), but there is no standard form for this. (An example is given in Appendix E of CIS 340 {<http://www.hmrc.gov.uk/new-cis/cis340.pdf>})

- **Existing gross/net payment status will transfer over to the new scheme**

So long as existing gross status doesn't expire before 6 April 2007

- **There will now be three types of payment status**

Gross	For sub contractors registered with HMRC and eligible for gross payment status (current holders of CIS 5 and 6 cards)
Net 18%	For sub contractors registered with HMRC and not eligible for gross payment status. The rate is 20% (prior to 5 April 2007 it was 18%). (Current CIS 4 holders)
Higher rate	For sub contractors not registered with HMRC – 30% from 6 April 2007.

- **No annual CIS return**

Goodbye to CIS36 annual return (once a year)....

- **A new monthly return to HMRC**

... and hello to son of CIS36 (new return doesn't have a number yet, but presumably this will follow).

The return must be sent in by 19th of each month by contractors for payments up to 5th of each month, and can be sent by post or internet. HMRC will issue blank returns pre-populated with the names and details of sub contractors previously used.

Nil returns must be filed.

If a return is late, there is a penalty of £100 per month per return (or more if there are over 50 subcontractors). Watch this – if a contractor neglected to send in monthly returns and simply thought “I’ll do them all at the end of the year” then there will be 12 late returns, one 12 months late with 12 x £100 penalty, one 11 months late with 11 x £100 penalty, etc – the total over 12 months late returns would be £7,800.

- **A new status declaration**

The existing rules on self employed or employed status are not changing.

Contractors will have to make a declaration each month, on the return, that they have considered the employment status of each sub contractor and they consider them self employed.

- **A new compliance test for gross payment status**

Based on 12 months rather than 36 months, but harsher regarding non compliance than at present.

- **New conditions for subcontractors getting gross payment status**

Construction turnover of £30k in the last 12 months (for partnerships/companys it is £30k x number of partners / directors / major shareholders – or a flat £200k alternative test)

The old 3 year average and £21k in 6 month tests have gone.

EMPLOYMENT STATUS

The existing rules on employment versus self employment still apply. There have been no changes to these.

However be aware that HMRC guidance on employment v self employment, some of this issued with HMRC guidance on new CIS, is selective and biased in favour of employment. Key legal points are overlooked or downplayed in HMRC guidance.

In most cases if a genuine self employed contract is in place and being worked to then self employed status will still be correct.

OUTLINE OF THE CIS SCHEME

Because of the itinerant labour force, many years ago special rules were introduced by HMRC to require business (called contractors) in the construction industry to deduct tax from certain self employed workers and businesses (usually called sub contractors). A business can be a contractor and a sub contractor simultaneously.

Basically there are three classes of workers in the construction industry:

Directly employed	Paid with deduction of tax and NI under PAYE. Considered an employee of the contractor.
Self employed – net paid	Paid with a flat rate deduction of 20% for tax/NI. Not considered an employee of the contractor. Completes own tax return and accounts each year and pays difference between 20% and actual tax/NI liability. A higher rate of deduction – 30% – will apply after April 2007 for sub contractors not registered with HMRC.
Self employed – gross paid	Paid gross, with no deductions. Not considered an employee of the contractor. Completes own tax return and accounts each year and pays tax/NI liability then.

There are no real bars to basic registration and more or less anyone can register to be self employed in the construction industry.

Initially any registration will be set up on a net payment basis, i.e. with 18% deducted.

If the individuals income (less materials supplied) is over £30k pa in the last 12 months then they can apply for gross payment status.

WHAT WORK IS CAUGHT BY THE CIS SCHEME

The scheme applies to contracts between businesses in the construction industry. For example an electrician carrying out work for a builder is included whereas the same electrician carrying out work for a haulage contractor or for a private household is not included.

Likewise a builder carrying out work for another construction company or a developer is included, but the same builder carrying out work for a grocery shop or a private household would be excluded. There is one exception here: if the grocery shop is part of a chain and spends on average £1m a year or more on construction work then it is deemed to be a contractor and falls within the scope of the scheme.

Local authorities, government departments and public bodies are also deemed to be contractors if they spend £1m a year or more on buying in construction services.

The scheme only applies to the provision of labour related construction services; an electrician supplying electrical services to a builder is covered but a wholesaler supplying electrical materials only is not included. An auto mechanic supplying services to a builder, with or without materials is excluded; this work is not a construction service.

Professional services such as architectural or surveying services are excluded from the scheme.

The scope of services included in the scheme can be surprising; a contract cleaner or a gardener who works on a construction project is caught for example.

If there are doubts over the scope of the scheme then please contact us or HMRC for advice; there is a detailed list available on the HMRC www site of the ins and outs, and HMRC will rule on uncertainties.

The scheme works in an almost identical fashion regardless of whether the contractor or the sub contractor are individuals, limited companies or partnerships, and it is possible to be both a contractor and sub contractor at the same time, eg if A does work for B and A gets C to do some of the work, then the chain is B > A > C, and A is both a sub contractor (to B) and a contractor (to C).

CIS IN PRACTICE

As can be seen CIS is a kind of half way house between self employment and full employment.

The final tax bills and cost to contractor and worker are the same as self employment, but the tax deduction obligations and documentation are similar to PAYE and employment.

Most of the day to day compliance obligations fall onto the contractor. They must:

- Consider the status of each sub contractor before the engagement starts
- Verify the sub contractor with HMRC by telephone or internet
- Deduct tax from deduction cases
- Complete a monthly return
- Pay deductions across monthly (for small employers, quarterly)

STATUS

Status – more correctly employment status – is the question of whether someone is employed or self employed.

The CIS scheme only applies to the self employed, and if some one is employed they should be subject to PAYE/NI deductions under a payroll scheme.

When making monthly returns to HMRC contractors need to make a declaration that they have considered the employment status of each sub contractor on the return and they are happy they are correctly classified as self employed – there is a potential penalty of £3,000 for getting this wrong.

Status causes much confusion and has always been a hot issue in the construction industry, so we have a separate guide on this on our www site (www.garbetts.com/cis). The important factors are generally held to be:

- Personal service - is the subcontractor obliged to work personally (suggests employment) or can he hire assistance / send a substitute/alternate (suggests self employment)
- Control – is there detailed control over how the work is done, if there is it suggests employment (NB detailed control over how the work is done is not the same as a detailed instruction as to what is required to be done)
- Mutuality of obligations – for employment to exist there must be mutual obligations – the contractor must be obliged to offer work, and the sub contractor to accept it – if those mutual obligations are not there then self employment is suggested.

There is no statute on employment status, but case law suggests that if any of the above three points are missing then there cannot be employment, and the arrangement must be self employment.

It is very important that attention is paid to status. The risks are with contractors, but sub contractors also need to help themselves as well. Pay attention to the following:

- Contract - it is important that all self employed operatives have a contract with the contractor. In the case of partnerships and limited companies the contract should be between the partnership/company and the contractor, not the worker and the contractor.

It is good practice to renew contracts on a regular basis, eg every new project or every three months.

- Invoicing - it is important that self employed workers invoice the contractor for the work they do and they are paid against invoices.
- Advertising – self employed workers contractors should periodically advertise their services in the local press, shop window, etc, and keep copies of the adverts.
- Business organisation – self employed workers who can demonstrate they have the trappings of a business organisation will fare better in proving self employment. Such trappings could be a business phone line, a business mobile phone, headed paper, using an accountant, sign written van, advertising, business insurance.
- Differing contractors - if self employed workers work for different contractors it will make their case stronger. This could be achieved by them sub contracting for each other, with them taking turns at "leading" on jobs. Even better, some of the different engagements should be simultaneous.
- Price work - submitting tenders for jobs and working to price, and showing evidence of this, will assist.
- Provision of loose tools and overalls.

VERIFICATION

Before they can pay a sub contractor, a contractor must verify the subcontractor with HMRC. This can be done by telephone or internet. It should, however, not be done until a contract is agreed or tender accepted – i.e. it should not be done speculatively.

To verify a sub contractor, the contractor will need:

- Name
- Tax reference
- NI number if known
- Partners tax reference (partnerships only)

In general you only need to verify a sub contractor once. You only need to re-verify them if you haven't used them in the current tax year or either of the two previous years.

If you are paying a subcontractor in the first tax year of the new scheme, i.e. up to 5 April 2008, you do not have to verify them if:

- You have already included them on a monthly return in that tax year; or
- You have paid the subcontractor since 6 April 2005 and when you last paid them they had one of the following:
 - A registration card CIS4, or
 - A temporary registration card CIS4(T) that expired after March 2007, or
 - A CIS5 or CIS6 that expired after March 2007

You can continue to use the payment status that you last used – e.g. gross if they had a CIS6 card, net if they had a CIS4 card etc, as long as you have no reason to believe that the subcontractor's status has changed.

When a sub contractors status changes from net to gross or vice versa HMRC will notify all contractors for whom the subcontractor has worked in the last 12 months.

DEDUCTIONS

When a sub contractor is verified the contractor is told whether they are:

- To be paid gross
- To be paid under standard 20% deduction
- To be paid under special higher rate deduction of 30% (applicable to sub contractors who are not registered with HMRC).

Deductions must be made up to 5th of each month.

For deduction cases a statement must be provided to the sub contractor by the 19th of each month (so a 14 day window), showing:

- The contractor's name
- The contractor's employer's reference
- The tax month to which the payments relate or the date of the payment
- The subcontractor's name
- The subcontractors unique taxpayer reference (UTR)
- The total amount of payments in the tax month
- The amount of materials
- The amount of deductions
- The verification reference

There is no specified format for this, but there is an example at Appendix D of HMRC guidance CIS340.

Caution should be taken about providing "payslips" with employment type wording to sub contractors – this can be seized on and used against the contractor in a status dispute with HMRC. Previously contractors have been known to administer 18% deductions via their (employee) payroll software and issue the same style of payslips to sub contractors and employees – this is not a good idea.

RETURNS

Contractors have to make a monthly return to HMRC. This has to be made by 19th for sub contractor payments to the 5th of the same month, i.e. 14 day window.

The return can be made by internet or post. Blank returns will be sent out by HMRC with sub contractor details pre populated based on previous payments.

If there are no payments to be made, then a nil return must still be sent in.

If a return is late, there is a penalty of £100 per month per return (or more if there are over 50 subcontractors). Watch this – if a contractor neglected to send in monthly returns and simply thought "I'll do them all at the end of the year" then there will be 12 late returns, one 12 months late with 12 x £100 penalty, one 11 months late with 11 x £100 penalty, etc – the total over 12 months late returns would be £7,800.

There is a penalty of up to £3,000 for incorrect returns – each monthly return can qualify for a penalty, so perpetuate the same error for a year and the penalty could be £36,000.

PAYING DEDUCTIONS ACROSS

Deductions must be paid to HMRC by the 19th of each month. If there are paid late they can affect a businesses entitlement to gross payment status as a sub contractor itself.

If all PAYE / NI/ CIS deductions are less than £1,500 per month, then you can apply to pay quarterly (but you must apply, you cannot just do it).

GROSS PAYMENT STATUS

In order to achieve gross payment status, a sub contractor needs to register with HMRC, and will need to pass the following tests:

- Business test
- Turnover test
- Compliance test

The business test involves demonstrating you are in business in the UK and agreeing to operate with a business bank account.

The turnover test has different requirements for different types of sub contractors:

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| Sole traders | - must show £30,000 of construction turnover in the 12 months before applying for gross status |
| Partnerships | - must show £30,000 of construction turnover per partner in the 12 months before applying for gross status, or they must pass the alternative test of showing a £200,000 turnover |
| Companies | - must show £30,000 of construction turnover per director / major shareholder in the 12 months before applying for gross status, or they must pass the alternative test of showing a £200,000 turnover |

Construction turnover is income under the CIS scheme after deduction for materials and plant running costs. There is a concession whereby if construction turnover is less than £30,000 (or £30,000 x number of partners / directors / shareholders) but total turnover including income not under CIS (eg work for a member of the public) exceeds the £30,000 threshold then HMRC may allow registration on a discretionary basis.

The compliance test looks at compliance over the last 12 months. There is a shorter period than the old test for getting a CIS6 certificate which focused on the contractor's compliance over a three year period. The new test looks at a 12 month period, but the rules are much stricter.

To pass the compliance test, you and any business partners (or your company and each of its directors) must, during the 12 months up to the date of the application, have done all of the following:

- completed and returned all tax returns sent to you.
- supplied any information to do with your tax that HMRC have requested.
- paid by the due dates
 - all tax due from yourself or the business
 - all your own National Insurance contributions (NICs)
 - any PAYE tax and NICs due from you as an employer
 - any deductions due from you as a contractor in the construction industry.

When considering whether you have passed the compliance test, HMRC will disregard, during the same 12 month period, any or all of the following:

- three late payments of CIS/PAYE deductions – up to 14 days late.
- three late submissions of the monthly return – up to 28 days late.
- one late payment of Self Assessment tax – up to 28 days late.
- any employer's end of year return made late.
- any late payments of Corporation Tax – up to 28 days late, including where any shortfall in the payment has incurred an interest charge but no penalty.
- any Self Assessment return made late.

This will be a 'rolling' compliance test – i.e. as soon as you pay HMRC more than 14 days late, your gross payment status will be withdrawn.

IMPORTANT - Under the new compliance test, if you pay your PAYE/CIS deductions more than 14 days late **even just once** you will lose your gross payment status and go onto deduction. This is likely to catch out a huge number of contractors if they are not ready for the new scheme. Unlike the old scheme, there will be no discretion available to the Inspector or the appeal commissioners if you do not comply.

PENALTIES

The CIS scheme places a raft of penalty provisions at HMRCs disposal:

If you...	The penalty is...	Statutory reference...
Fail to send in the monthly return to HMRC (including a nil return).	£100 per 50 subcontractors (or part thereof) per month. After 12 months a penalty of up to 100% of the undeclared CIS deductions, subject to mitigation.	Regulation 4(12)(a) of the Income Tax (Construction Industry Scheme) Regulations 2005, or Regulation 4(12)(d) in the case of a nil return, applies penalties under section 98A(3) TMA 1970 to monthly returns.
Send in an incorrect monthly return (either negligently or fraudulently).	Up to 100% of the under-declared CIS deductions, subject to mitigation.	As above, under section 98A(4) TMA 1970.
Fail to produce CIS records for HMRC to inspect when required to do so.	Up to £300 penalty, plus up to £60 per day for continuing failure.	Schedule 12 para 7(4) inserts the monthly returns provisions under section 70(3) FA 2004 into section 98 TMA.
Fail to provide a subcontractor with a 'payslip'.	Up to £300 penalty, plus up to £60 per day for continuing failure.	Schedule 12 para 7(5) inserts the provisions under section 70(1)(c) FA 2004 into section 98 TMA.
Make a false statement in order to register for gross payment or payment under deduction.	Up to £3000.	Section 72 FA 2004.
Make an incorrect declaration about employment status (either negligently or fraudulently)	Up to £3000.	Schedule 12 para 7(5) inserts the monthly return provisions under section 70(1)(a) FA 2004 into section 98 TMA.