

HMRC consultation - Tackling Construction Industry Scheme Abuse

HMRC have recently issued a consultation document 'Tackling Construction Industry Scheme Abuse', which seeks to explore ways to prevent tax loss in the Construction Industry Scheme (CIS).

A number of the proposals are relatively straight forward and should be welcomed by most Contractors and Sub-Contractors, who already abide by the current Regulations, as they are designed to ensure that the small minority who abuse parts of the current system can quickly be held to account and will no longer gain a potential advantage over their competitors.

However, one of the proposed changes outlined, the Site Registration Scheme, could have a significant impact on larger Contractors, as its implementation is likely impose further administration costs on all projects which could, in turn, have an impact on smaller contractors and sub-contractors engaged by the main project contractor.

We have attached a copy of the document for your information and have also summarised the key proposals/suggested actions below.

Consultation Proposals

Correcting the CIS deductions claimed on an EPS

The issue

The CIS permits limited company sub-contractors to set off CIS deductions suffered against in-year employer liabilities. This facility was introduced to ease cash-flow for sub-contractor companies unable to secure Gross Payment Status. HMRC state that they are aware that some employers are using this process to falsely reduce their tax liabilities, to create spurious sums to set off against other tax liabilities, or to create false repayments for themselves and/or their sub-contractors.

The proposed solution

In order to tackle the abuse, a new provision will be introduced from April 2021 to allow HMRC to correct the CIS deductions figure claimed on the sub-contractor employer's EPS return where there is no satisfactory evidence to support it.

HMRC will have the power:

-  to correct the CIS deduction figure an employer has recorded on an EPS return; and
-  to prevent the employer from setting further CIS deductions against their employer liabilities for the rest of the same tax year where the correction power has been used.

Interest and penalties may also be charged.

Where HMRC consider that there are discrepancies, they will contact the employer/sub-contractor and ask for, within 14 days, an explanation, and/or evidence, to confirm whether the employer is entitled to a set-off and in what amount.

Deemed contractors

The issue

The HMRC view is that the current rules used to determine whether a business, undertaking construction operations, is a 'deemed contractor' are being abused.

HMRC has evidence that some contractors are manipulating both the amount and timing of construction payments, or altering their accounting periods, to ensure they do not fall within the deemed contractor rules.

The proposed solution

HMRC will simplify the current rules to ensure businesses spending above a certain amount on construction operations have to operate the CIS when the threshold is reached.

When, on a rolling basis, a business's construction expenditure under a construction contract exceeds £3 million, they will need to ensure they have registered as a contractor with HMRC and operate CIS on the next payment they make to a sub-contractor for construction operations undertaken via this contract.

The deemed contractor can stop operating CIS when the relevant contract is satisfactorily completed, and no further payments on construction operations (including retention or management/administration payments) are expected to be made under that, or any other construction contract.

Deductions for materials

The issue

Currently, prior to calculating the appropriate CIS deduction from tax deducted sub-contractor payments, contractors are required to deduct the cost of any materials purchased by the sub-contractor that are needed to fulfil the construction contract that exists between them and the contractor.

HMRC state that some contractors and sub-contractors are interpreting the rules to mean that every sub-contractor in the chain working on the same overarching project can take a deduction for materials used, even if they did not directly pay for those materials.

The proposed solution

HMRC intend to rewrite the rules to make it clear that a materials deduction for CIS purposes can only be made from a payment under a construction contract where a sub-contractor has directly purchased materials used, or to be used, in fulfilling that contract.

Expanding the scope of the false registration penalty

The issue

HMRC can penalise a person for providing false information when registering for CIS. This penalty applies only to the individual or business to whom the registration applies. However, the penalty does not deter the non-compliant, fraudsters, or their associates from persuading or coercing others to register for CIS by providing HMRC with false information, or from hijacking IDs and making repeated CIS registrations.

The proposed solution

The Government has decided the penalty will be applicable to a 'relevant person'. This will include an agent, director, company secretary, or anyone HMRC believes is in a position to exercise control and direction over the business and/or the person making the CIS registration.

Site Registration Scheme (consultation on supply chain proposals)

The issue

HMRC are aware that organised fraud in labour provision is being used to extract cash from the tax system. The fraudsters artificially lengthen construction supply chains to make it difficult for HMRC to reconcile the main contractor's CIS declaration to all sub-contractors below it. Once established, the fraudulent business acts like legitimate businesses, producing the necessary documentation, using apparently legitimate workforces to undertake legitimate activities to fulfil construction contracts. The effect of these arrangements is that these companies, and the labour force they deploy, are deliberately not paying tax and NICs.

The proposed solution

The proposals are designed to signal that larger contractors have a role to play in tackling fraud in the construction sector in conjunction with HMRC. The proposals are intended to improve HMRC's knowledge of the sector, encourage supply chain due diligence, allow HMRC to undertake more extensive supply chain assurance activities, and to tackle non-compliance more quickly to the benefit of all compliant businesses.

HMRC are considering requiring the contractor to provide information to HMRC, to link sub-contractors and payments to specific contractor sites/locations/construction contract.

HMRC are also considering requiring 'main contractors', so those at the top of the construction chain, to notify them of their supply chain for a particular project or contract. This could encourage those contractors to undertake more extensive due diligence regarding who they engage and who their sub-contractors engage. The main contractor would be required to flag any concerns to HMRC, particularly around chains that seem unnecessarily long, or where entities cannot be readily identified. HMRC could then investigate any suspect entities in the chain.

The proposed checks for contractors to undertake on sub-contractors in the supply chain under discussion could include:

- 👉 verifying the sub-contractors with HMRC to check they are registered for CIS, VAT, other taxes;
- 👉 checking they are registered with Companies House (if a company or large partnership);
- 👉 checking how long they have been trading;
- 👉 checking their addresses and telephone numbers are genuine;
- 👉 asking for copies of their insurance cover and last accounts;
- 👉 checking their workers are eligible to work in the UK;
- 👉 checking the directors/partners are "fit and proper" persons.

Where HMRC is aware of fraud in a VAT supply chain they will tell the entities in the chain about this and encourage them to undertake due diligence activities. This proposal would extend this process to CIS supply chains, in particular notifying fraud to the main contractor. HMRC would encourage the contractor to identify the perpetrator and remove them from the chain, or to ensure CIS deductions are applied retrospectively to payments those entities have received.

Where the fraud continues, for instance where HMRC considers that the main contractor takes no or ineffective action to address the fraud, HMRC could:

- 👉 prevent them from paying their sub-contractors gross; and/or

 hold them responsible for tax losses due to fraud lower down the supply chain.

[Link to HMRC consultation document](#)

[Click here](#) to access HMRC's consultation document.

The proposed closing date for responses is the **28th May 2020**.

If you have any questions regarding this, or any other Employment Tax issue, please contact a member of Smith Cooper's Employment Tax team.