

The CIS: some cautionary tales

David Brindley and Jas Jhooty set out some of the common pitfalls in the Construction Industry Scheme (CIS), including examples of where things can go wrong

Throughout our careers in tax we have both come across clients making errors in the CIS regime. The most common cases are usually due to ignorance or naivety rather than any deliberate intent.

The nuances of the legislation make this area complex to navigate and, as such, if any construction activity is being conducted (however minor or for whatever reason) it is important to ensure that you do not unwittingly fall into the scheme.

From a net financial position, failure to apply CIS properly can result in more dire consequences than most other tax regimes, should there be a failure to apply it properly. This is due to the fact that it can result in a consequence where the contractor will have paid the tax-inclusive amount to the sub-contractor (which they may not be able to get back) and then have to also pay the tax for the sub-contractor, resulting in a double charge for the contractor.

Am I a contractor?

There are a lot of things that can go wrong with CIS but, by far, the most common issue that we have come across is where the contractor is a deemed contractor, unbeknownst to them. This happens on occasions where non-construction businesses spend over £3 million on construction-related work in any rolling 12-month period. For medium or large companies, it is especially easy to lose track of the expenditure and unknowingly fall into the regime.

Similarly, on some occasions, even if the company is below the threshold, it can still be treated as within CIS as a mainstream contractor. We have dealt with multiple HMRC enquiries where this is the case, for example where property investors (who may develop properties to commercially rent or sell) should be registered as mainstream contractors from the outset.

In both these scenarios failure to register as CIS contractors may result in HMRC pursuing the client for not filing the requisite monthly CIS returns and failing to pay over tax that should have been withheld. If the client was fortunate enough to only have dealt with CIS sub-contractors who held Gross Payment Status then we may be able to argue that there was no tax loss to HMRC, but penalties for late filing would still arise.

Going green

Linked to the deemed contractors are errors around green expenditure. Given the government's pledge to make the UK more environmentally friendly, it is easy to overlook the fact that construction on green infrastructure may fall within the remit of CIS and could make someone a deemed contractor.

In recent times we have come across various times where HMRC have commenced CIS enquiries and have identified the company to be a deemed contractor, which has caused some real issues for large and medium sized companies. We have found that some companies that specialise in installing electronic vehicle (EV) chargers at the roadside have not considered that this is actually a construction operation and may have failed to register for CIS. The construction of windfarms is caught within the definition of construction operations. This is extremely important for multinational construction contracts.

Mixed use contracts

Extra care should be taken if any offshore construction crosses tax jurisdictions. One of the rarer, more complex areas is ensuring that contracts are appropriately separated to ensure splits in the jurisdiction of where the work is undertaken. This is because of a little-known rule of CIS where any contracts that contain any mixed-use provisions are entirely caught within CIS. If the contracts are not split correctly, we have found that CIS can be applied to all payments. For example, if the construction project is in the UK and Ireland and only one contract is made, the Irish element could be subject to UK tax.

Whilst there may be relief provided further down the line, for cash flow purposes, it could significantly harm the project and require a significant amount more capital to be introduced. As such, it is important to ensure the contracts entered into in such a way that there is sufficient division of services at each tax jurisdiction.

Gross payment status

Given the nature of the construction industry, it is easy for contractors who have relationships with their subcontractors to trust what they are told by the sub-contractors without checking. For gross or net payment status payment status it is easy to take them at their word and pay them according to this. It is only then later, when informed by HMRC during an enquiry that the sub-contractor had not attained a net pay or a gross payment status, that contractors realise more diligence should have been taken and they end up footing the bill.

We have seen examples where a seemingly reputable subcontractor with a long-term business relationship with the contractor assures the contractor that their new venture has gross payment status. After a few years of trading and, shortly after the commencement of an HMRC enquiry, the subcontractor disappeared leaving the contractor with a c.£300,000 liability.

The other point is that companies can lose their gross payment status if they fail to comply with all their HMRC filing obligations. It is essential to regularly check the status rather than conducting one check and then believing this is sufficient indefinitely. These checks should be undertaken every two years as a minimum.

Overly cautious?

We have found, given the vast array of potential pitfalls, some clients have registered for the CIS regime if they think there is even a possibility that it could apply.

In some more recent examples we have seen clients have registered as CIS contractors/sub-contractors:

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For the installation of cameras on public transport by misinterpreting the definition CCTV installation for traffic management.

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Registering prior to the £3m threshold resulting in having to prepare and submit CIS returns unnecessarily early.

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Misunderstanding contractor vs. subcontractor roles: incorrectly registering as a contractor when they are actually a subcontractor (or vice versa).

Whilst some of these examples may seem like a prudent approach to take, it can impact cash flow and therefore seeking advice on CIS before jumping in and registering is commercially the better route to take.

Final thoughts

As shown in the few points above, covering just some of the main mistakes we have come across, there are a myriad of potential ways CIS can go wrong.

As mentioned at the start of this article, ignorance and naivety of clients can sometimes mean they unwittingly fall foul of the rules. Whilst there are defenses to be had should a company fall foul of the rules, the best defence against HMRC challenge is to apply CIS correctly in the first place. In some of the examples we have given, due to the particular fact pattern of the cases, we were able to successfully challenge HMRC's conclusions and agree with them that no tax liability was due. However, caution needs to be taken as a successful defence is by no means a certainty and it was only due to the particular facts of the cases that we were able to reach agreement with HMRC.

It is for us as advisors to ensure that the correct specialist help is given where appropriate to proactively ensure HMRC enquiries are avoided or resolved with no additional tax being due.

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