



HM Revenue
& Customs

Tackling Construction Industry Scheme Abuse

Consultation Document

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| Subject of this consultation: | This is a consultation concerning ways to tackle abuse of the Construction Industry Scheme (CIS). |
| Scope of this consultation: | The consultation seeks views on changes to the rules to prevent tax loss from the CIS. Chapter 3 explains a new power to allow HMRC to correct the CIS deduction amounts claimed by sub-contractors on their Real Time Information (RTI) Employer Payment Summary (EPS) returns and seeks views on the implementation process. Chapter 4 sets out the changes to existing rules to clarify their meaning or expand their scope and asks whether there are other changes that could be made to tackle abuse of the CIS. Chapter 5 sets out some early ideas around construction supply chains and asks whether they would help prevent tax loss and so merit further consideration. |
| Who should read this: | We want to hear from anyone who works in construction, who operates within the CIS, or who represents construction businesses. We are particularly keen to hear from sub-contractor employers who set off CIS deductions in-year against their employer liabilities, and larger contractors at the top of supply chains who would be most affected by the supply chain proposals. |
| Duration: | 10 weeks starting on 19 March 2020 and ending 28 May 2020. |
| Lead official: | Stephanie Allistone: HMRC, Tax Administration Policy & Strategy Team. |
| How to respond or enquire about this consultation: | Please send responses to: cisconsultations@hmrc.gov.uk Alternatively you can write to: Stephanie Allistone Tax Administration Policy & Strategy Team HM Revenue & Customs Floor 5, 1 Ruskin Square CROYDON, CR0 2WF |
| Additional ways to be involved: | Please send enquiries about the content or scope of the consultation, or requests for a hard copy to the above address. Respondents can submit written responses in the normal way. If you would like to arrange a meeting to discuss the content of this consultation please use the email or postal addresses above. |
| After the consultation: | A summary of responses to the consultation will be published. The responses will assist in drafting the legislation, guidance and communications required to deliver the changes, in developing other measures to tackle abuse, and in further developing the supply chain ideas. Legislation relating to the measures set out in Chapters 3 and 4 will be published for consultation in 2020 and included in Finance Bill 2020/21 for commencement in April 2021. |

Getting to this stage:

HMRC published a consultation in March 2017 entitled 'Fraud on provision of labour in the construction sector'. This document is available at the following link:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/601034/Fraud_on_provision_of_labour_in_construction_sector_consultation_on_VAT_and_other_policy_options.pdf

The Summary of Responses is also available at the link below:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/663934/Fraud-on-provision-labour-construction-sector_consultation-VAT-otherpolicy-options-responses.pdf

Following the 2017 consultation the government decided to introduce a VAT reverse charge from October 2020 to tackle the VAT elements of labour fraud in construction. Further work has been undertaken on the income tax issues associated with labour fraud, as well as to review the CIS rules generally to ensure the scheme continues to protect the Exchequer as originally intended. Respondents to the 2017 consultation suggested several options for strengthening the CIS rules, including changes to the rules for securing 'gross payment status' (GPS). Although no changes to the GPS rules are proposed at this time, the government will continue to keep this area under review and further suggestions on GPS are welcome as part of this consultation.

The changes set out in this document are designed to continue to tackle abuse of the CIS rules, ensuring HMRC can act quickly where the rules are being broken and level the playing field for all those operating within construction.

This consultation also sets out some early ideas on measures to promote supply chain due diligence in the construction sector. Such measures would help tackle fraud in the sector by encouraging large contractors to take responsibility for identifying all the parties within their supply chains and to provide reliable information to HMRC throughout the life of a construction project.

Previous engagement:

There has been recent sector engagement around the 2017 consultation to discuss tackling labour fraud in construction and the learning from that engagement has been used in developing this consultation.

1. Introduction

1.1 The government recognises that the majority of businesses in the construction sector meet their CIS obligations in full and on time. But a minority of businesses are abusing the rules to extract cash from the tax system and to falsely reduce their tax liabilities. This allows them to gain an unfair cash-flow advantage over their competitors, and to deprive the Exchequer of money needed to fund public services.

1.2 In order to tackle this abuse, as announced at Budget 2020, from April 2021 HMRC will be able to correct the amount of CIS deductions claimed on a sub-contractor employer's return where they identify or suspect inaccurate amounts have been claimed. Other changes include clarifying the law regarding the CIS rules on 'materials deductions' and 'deemed contractors'. In the longer term the government is considering introducing measures to improve the information available to HMRC about construction supply chains and to encourage contractors to undertake supply chain due diligence to support CIS compliance by all parties within the chain.

1.3 This consultation sets out these changes and seeks input in three areas:

- on the measure designed to ensure CIS deductions claimed by employers are permitted only where there is satisfactory evidence to support them, particularly on the implementation of the proposed provision (Chapter 3);
- other ideas, or rules within the CIS that could be clarified, to minimise misinterpretation and abuse (Chapter 4); and
- feedback on the supply chain measures which are at an early stage of development (Chapter 5).

1.4 The consultation is in 8 chapters with a summary of questions at Chapter 7.

2. The Construction Industry Scheme

How it works

2.1 Construction is an industry with a large, mobile workforce with many sub-contractors paid in cash. This makes the sector attractive to the non-compliant who seek to extract cash from the system, leading to Exchequer losses. The CIS was introduced to address widescale non-compliance in this sector and has operated in some form since the 1970s, going through various stages of modernisation.

2.2 The CIS provides that on making a payment to a sub-contractor under a construction contract, the contractor must deduct a certain percentage of the payment on account of tax. Sub-contractors that are not registered with the CIS have a 30% deduction made and those registered have a 20% deduction made from their payments, unless they meet specific qualifying criteria which entitle them to receive payments gross. Contractors are required to verify the payment status of their sub-contractors with HMRC who will advise the contractor to either make gross payments or to apply the appropriate percentage deduction.

2.3 Contractors must deduct the cost of any materials purchased by the sub-contractor that were needed to fulfil the construction contract before applying the tax deduction to their payment. They must also provide the sub-contractor with a written statement of the CIS deductions they have made from their payments each month.

2.4 The contractor records CIS payments and any deductions made on their monthly CIS return which they submit to HMRC. The contractor pays the CIS deductions over to HMRC each month. The deducted amounts are held by HMRC as payments on account of the sub-contractor's end of year tax liability. Legislation then provides for an order of priority in which the deducted sums are treated as meeting the sub-contractor's tax liabilities or National Insurance Contributions (NICs), depending on whether or not the sub-contractor is a company. Once a sub-contractor sends in their self-assessment tax return they are required to pay any additional balance of tax or NICs due or, if appropriate, receive a repayment where their CIS deductions exceed their final end of year tax and NICs liabilities.

Sub-contractor companies that are also employers

2.5 Sub-contractor limited companies that have had CIS deductions made by contractors from payments received for construction work are entitled to have those deductions set off against their employer liabilities. They can do this by sending HMRC an EPS return, which is completed through RTI reporting. This in-year set-off process is designed to ease cash-flow for limited companies suffering deductions under CIS.

Deemed contractors

2.6 Some businesses outside mainstream construction regularly carry out or commission construction work. These businesses are commonly known as deemed contractors and must operate CIS if their average expenditure on construction operations in each of the three years ending with their last accounting date exceeds £1 million.

3. Correcting the CIS deductions claimed on an EPS

The problem

3.1 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 GPS. However, HMRC is 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.

3.2 HMRC is aware that CIS deductions suffered are being claimed:

- by employers not working in construction;
- by sub-contractor employers that are not companies; and
- that exceed the sums recorded as having been withheld for a particular sub-contractor on contractor returns.

3.3 In these cases HMRC asks employers to provide evidence of eligibility and/or evidence of the sums deducted and when appropriate to correct their EPS return accordingly, but where the employer does not do this tax is lost because there is an underpayment of employer liabilities.

The solution

3.4 The government has decided that in order to tackle this 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.

3.5 The government's proposal is to provide HMRC with a 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.

3.6 The CIS and Pay As You Earn (PAYE) regulations and NICs legislation contain various provisions designed to allow HMRC to secure payment of sums not declared or not paid over by the employer or contractor. This legislation is set out at Annex A, but it does not allow HMRC to quickly and effectively deal with the non-compliance described above either during or following the end of a tax year.

3.7 This chapter continues by setting out the detail on the new power and asks for views on:

- preventing later set-off or repayment claims for CIS deductions where HMRC has used the new correction power;
- the interest and penalty consequences of HMRC correcting CIS deductions claimed on a sub-contractor employer's EPS return;
- what could constitute suitable evidence of CIS deductions suffered;
- timings for providing that evidence to HMRC and for employer correction of an EPS return; and

- taxpayer safeguards.

Current process and new steps

3.8 The following paragraphs describe the current process and the new steps HMRC will take once this power is available.

Current process

3.9 Where HMRC suspect the CIS-PAYE set-off facility is being abused HMRC check their records to determine whether:

- the employer is a limited company;
- the employer is operating in construction; and
- the CIS deductions claimed on the EPS return match, or are less than, the sums shown as deducted on contractor returns which evidence the payments and CIS deductions made to that subcontractor.

3.10 Where there are discrepancies HMRC contact the employer and ask for an explanation and/or evidence to determine whether the employer is entitled to a set-off and in what amount.

3.11 Where satisfactory evidence is provided to demonstrate the amount of CIS deductions recorded on the EPS return is correct, then no further action is taken in respect of the sub-contractor employer. Where satisfactory evidence is not provided, HMRC ask the employer to amend the EPS return to reflect the correct amount being claimed for set-off.

3.12 If the employer is not a limited company or not operating in construction, the amount of CIS deductions claimed on the EPS return should be reduced to nil. The same applies if the employer cannot provide satisfactory evidence of any CIS deductions having been suffered in the tax year to date. Where HMRC has proof of some deductions but the employer is claiming more, then, if the employer is unable to provide satisfactory proof of the deductions claimed, they are asked to correct the amount claimed on the EPS return to match the figure HMRC can substantiate.

New steps

3.13 Where within the specified timescale

- HMRC receive no response to their enquiries, or
- the employer cannot provide satisfactory evidence of the CIS deductions claimed, or
- where the employer refuses to correct their return,

HMRC will correct the CIS deductions figure on the EPS return and will notify the employer of this and the resulting effect. If there is more to pay HMRC will tell the employer how much needs to be paid and when. If the correction reduces an amount available for set-off or repayment HMRC will tell the employer the revised amounts available. There will be no impact from this action on employees' tax and NICs records because the information on the employer's Full Payment Summary RTI returns feeds into those records. The EPS return simply allows the employer to adjust the amounts they have to pay HMRC each month by claiming statutory reliefs and set-offs as an employer.

3.14 Where HMRC correct the EPS return generally the employer will be prevented from setting further CIS deductions against their employer liabilities for the remainder of the tax

year. This will not be necessary in error cases as HMRC will expect the employer to make the correction via an EPS return rather than HMRC having to do it.

Preventing later claims for CIS deductions where HMRC has corrected the CIS credit

3.15 In order to prevent an employer from reclaiming in later returns any CIS deductions disallowed by HMRC, generally the employer will be prevented from setting CIS deductions against PAYE liabilities for the remainder of the relevant tax year.

3.16 For example, if HMRC correct the credit previously claimed relating to month 6 (October return) of tax year 2022/23 the employer will not be able to set any further CIS deductions suffered after this date against their employer liabilities for the remainder of the tax year, or after the tax year end (if the corrections relate to 2022/23). If further deductions have been suffered they will be available, following verification by HMRC, to set against other liabilities or for repayment after the end of tax year 2022/23. The employer will start the new tax year (2023/24) with a clean slate, and so be able to set off CIS deductions against employer liabilities again from month 1 (May return). HMRC may choose to monitor the claims from these employers for a period to ensure they remain compliant.

3.17 Where an employer belatedly provides genuine evidence of CIS deductions suffered HMRC will consider allowing them to set off further CIS deductions on a later EPS return.

Q1: Are there other circumstances where HMRC should allow an employer to claim CIS set-offs later in a tax year following HMRC correction of an EPS return?

Interest and penalties

3.18 In order to avoid a late payment interest charge the employer will need to pay any sums by the due date, so with their next routine remittance. These sums constitute reductions in earlier payments the employer was not entitled to claim, giving them an unfair cash-flow advantage. HMRC will apply interest if the revised sum is not paid on the next PAYE payment due date.

3.19 Late payment penalties are considered for employers after the end of the tax year, and these sums will feed in to those considerations should they be paid late.

Q2: Do you have any comments on the interest and penalty consequences of HMRC making these corrections to an EPS return?

Evidence of CIS deductions suffered

3.20 When seeking evidence of CIS deductions which a sub-contractor has claimed on an EPS return, HMRC generally expect the sub-contractor to provide the 'payment and deduction statements' (PDS) provided by their contractor. If these are not held HMRC would expect the sub-contractor to ask their contractor for duplicate statements. If this is not possible then HMRC may accept other suitable evidence, but a deposit entry in a bank account alone is unlikely to be acceptable unless it can readily be matched with an issued invoice.

Q3: Are there other sources of evidence HMRC should accept as proof that a CIS deduction on account of tax has been made?

3.21 Where the sub-contractor can provide such evidence and the contractor has either not filed the required CIS return or has failed to reflect the sub-contractor's deductions, HMRC will pursue the contractor for the failure to comply with the CIS rules.

3.22 Given the CIS is a compliance regime HMRC need to ensure evidence provided to support CIS deductions is genuine. Some contractors and sub-contractors may collude in providing false PDS to HMRC, so in such circumstances HMRC need to be able to disallow CIS set-off claims where they suspect such collusion has occurred. HMRC's use of the correction power will carry both an internal review and formal appeal right.

Q4: Do you have any comments on HMRC being able to disregard certain evidence in deciding to use the correction power?

Timing for providing evidence of deductions and employer correction

3.24 In order to change behaviour and encourage compliance HMRC need to be able to deal with this abuse in real time, as well as after the end of the tax year. Where HMRC ask an employer to provide evidence of deductions suffered they will expect to receive it within a specified timescale. This timescale will be 14 days. If that is not possible then HMRC will expect the employer to provide an explanation within that timescale as to when the information will be provided to HMRC. In order to claim a set-off against their employer liabilities, the employer must have satisfactory evidence of the CIS deductions suffered, so it is not anticipated that this timescale should be difficult to meet.

3.25 Where satisfactory evidence is not provided within 14 days or the employer does not contact HMRC to explain the situation, HMRC will tell the employer to correct the EPS return to reflect the verifiable position within the specified timescale. This correction should be made by the employer within a further 14 days from HMRC asking the employer to do so. Where this is not done HMRC will make the correction to the EPS return.

Q5: Is 14 days the right amount of time for the employer to provide evidence of CIS deductions suffered?

Q6: Is 14 days the right amount of time for the employer to correct the return?

Q7: If not, what timescale do you suggest?

Taxpayer safeguards

3.26 HMRC will correct an EPS return:

- where the employer is not a limited company;
- where the employer is not undertaking construction operations (as defined in the CIS legislation at section 74 Finance Act 2004);
- where the employer does not provide satisfactory evidence of the CIS deductions claimed;
- where the employer does not self-correct the EPS return to reflect the substantiated position; and
- in cases where HMRC suspect the evidence provided by the employer is not genuine.

3.27 Where the employer amends the return HMRC will take no further action. Where the employer provides evidence late HMRC will be able to reconsider the position. The employer will be able to ask HMRC to review the correction decision and where they are not satisfied with the outcome the employer will be able to appeal to the tax tribunal. Where the employer does not appeal against HMRC's correction but HMRC prevent further set-off of CIS

deductions the employer will also be able to seek an HMRC independent review of this decision and then appeal to the tax tribunal.

3.30 Employers will have the opportunity to either provide evidence of their CIS deductions or to self-correct their returns before HMRC make a correction. As this measure is designed to tackle abuse of the set-off process in near real time the government has decided that employers will not be able to continue to set-off CIS deductions against employer liabilities during the review and appeal process.

Q8: Does this review and appeal process provide adequate protection for sub-contractor employers making errors?

Q9: Should other safeguards be considered in relation to these powers? If so, what should those safeguards be?

Q10: Are there other options to disallow CIS deductions claimed on an EPS return that are not supported by satisfactory evidence?

Interaction with the Off-Payroll Working Rules

3.31 Where the off-payroll working rules apply, these rules continue to take precedence over the CIS rules. This means that contractors must first consider whether the off-payroll working rules apply before considering whether deductions need to be withheld under the CIS.

3.32 From 6 April 2020, medium and large organisations outside of the public sector will need to decide whether the off-payroll working rules apply to an engagement with individuals who work through their own intermediary. All public authorities will continue to make determinations as now. The reform, announced at Budget 2018, is designed to tackle non-compliance with off-payroll working rules by making medium and large organisations in the private and third sectors responsible for determining the tax status of individuals who work for them through an intermediary.

Example

3.33 ABC PLC, a large construction business, requires support to build a new plumbing system. ABC PLC contract with Rafael, who works through his own Personal Service Company, Plumbing Services Ltd. Under the off-payroll working rules, ABC PLC is required to assess whether the rules apply to the engagement with Rafael. If the off-payroll working rules apply, then ABC PLC will be required to deduct income tax and employee NICs, and pay employer NICs, when making payments to Rafael's intermediary (Plumbing Services Ltd) for Rafael's services. If the off-payroll working rules do not apply, ABC PLC must then consider whether tax needs to be withheld on payments under the CIS. As Rafael's intermediary (Plumbing Services Ltd) is a company, Plumbing Services Ltd will be able to set off any CIS deductions suffered against its monthly employer liabilities.

3.34 If ABC PLC were a small construction company, Rafael would be responsible for determining whether the off-payroll working rules apply. In this situation, regardless of whether Rafael is in scope of the rules, ABC PLC will be required to consider whether tax needs to be withheld on payments to Plumbing Services Ltd under the CIS.

Further guidance on the off-payroll working rules can be found here:

<https://www.gov.uk/guidance/april-2020-changes-to-off-payroll-working-for-clients>

4. Other legislative changes

Deemed contractors

The problem

4.1 HMRC is aware that the current rule to determine whether a business undertaking construction activities constitutes a 'deemed contractor' is open to abuse. Compliance activity indicates that some contractors are manipulating both the amount and timing of construction payments, and that others are altering their accounting periods, to ensure they do not fall within the deemed contractor rules. This behaviour is compromising the CIS and putting at risk tax that could be secured at the very top of supply chains.

The solution

4.2 The government will simplify the current rule to ensure businesses spending above a certain amount on construction operations have to operate the CIS when the threshold is reached.

The current rule

4.3 The current rule to determine whether a non-construction business has to operate CIS requires

- a turnover threshold for expenditure on construction operations to be met, and
- a look back at the end of each period of account.

4.4 If at any time average annual expenditure on construction operations by a person or company carrying on a business exceeds £1 million in each of the last 3 years ending with the end of the last period of account, then that person or company will be considered to be a deemed contractor. They will then have to operate CIS on any construction expenditure from the start of the next period of account.

4.5 The deemed contractor is required to look back at construction spending at the end of each accounting period to see if they still meet the rule. They can only lose their deemed contractor status, and so the requirement to operate CIS, when their average expenditure is less than £1 million in each of three successive years.

4.6 This process is relatively complex and as stated above is relatively easy to manipulate.

The new rule

4.7 The government has decided that construction spending will be calculated on a rolling basis. When the cumulative spend on construction operations reaches the prescribed threshold the business has to register for CIS as a contractor (if not already registered) and begin operating CIS on their next payment made to a sub-contractor for construction operations undertaken.

4.8 Most businesses will know the amount of expenditure a construction contract they are entering into will likely incur when it is being negotiated, or at least when the contract is signed. The contractor may not know exactly when each payment under the contract will be due as this will depend on the project milestones being met on time, but this would not stop a contractor registering for CIS early in the life of the project to be prepared once their construction expenditure exceeds the deemed contractor threshold.

4.9 In line with the existing threshold (£1 million expenditure on construction operations in each of 3 years) the threshold will be £3 million. When a business's construction expenditure under a construction contract exceeds this figure, 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. This means businesses will no longer need to look back at the end of each accounting period to check construction expenditure in the previous three years.

4.10 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 problem

4.11 The wording of the rule covering deductions for materials is open to interpretation. Prior to calculating the appropriate CIS deduction from sub-contractor payments, contractors are required to deduct the cost of any materials purchased by the sub-contractor which that sub-contractor needed to fulfil the construction contract that exists between them and their contractor. Some contractors and sub-contractors are interpreting the rule to mean 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. This interpretation reduces the sums to which CIS applies at each level in the chain, undermining the purpose of allowing materials deductions within the scheme.

The solution

4.12 The government will rewrite this rule to make it clear that a materials deduction for CIS purposes can be made only 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 problem

4.13 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. As such it 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. Once registered the fraudsters can take control of the business and use it to extract cash from the tax system.

The solution

4.14 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.

Q11: Do you have other ideas that could protect the CIS from abuse?

Implementation timetable

4.15 The government will use the responses to the questions in Chapters 3 and 4 to develop draft legislation. That legislation will be published for consultation in Summer 2020 and included in Finance Bill 2020/21 with a commencement date of 6 April 2021. HMRC will publicise the changes and update its guidance ahead of commencement.

5. Early consultation on supply chain proposals

The problem

5.1 The 2017 consultation explained how organised fraud in labour provision is being used to extract cash from the tax system. The fraudsters insert themselves, almost anonymously, into construction supply chains, artificially lengthening those chains to make it difficult for HMRC to reconcile the main contractor's CIS declaration to all sub-contractors below it. Once established they act like legitimate businesses, producing the necessary documentation, using apparently legitimate workforces to undertake legitimate activities to fulfil construction contracts.

5.2 The effect of these arrangements is that these companies, and the labour force they deploy, are deliberately not paying tax and NICs. Overall, the losses from this type of fraud are significant.

The solution

5.3 The government believes measures designed to allow HMRC to better assure construction supply chains and to encourage supply chain due diligence will help combat this fraud.

The 2017 consultation

5.4 The responses to the 2017 consultation indicated:

- that some contractors undertake rigorous due diligence activities, but usually only on those entities they intend to directly engage;
- little is known about the firms that tender for work other than the price they offer, basic tests of their financial competence, and their ability to complete the work on time;
- that contractors do not ordinarily have access to the ownership structure of their sub-contractor firms nor any knowledge as to the accuracy of any information they are given; and
- that some contractors will periodically undertake checks on the ownership and financial status of their suppliers, and most will check this before taking them on, but it may then happen only very sporadically, and certainly not frequently enough to detect or prevent fraud.

5.5 It was also suggested the government should aim measures at the potential fraudsters rather than their customers, and that HMRC should make better use of the information it has to identify and target the fraudsters.

5.6 The government considered these responses carefully and decided to introduce the domestic VAT reverse charge from October 2020 to address the VAT element of labour fraud in construction. It was decided not to take steps to strengthen the access tests for securing GPS under the CIS at this time; rather HMRC would revisit its compliance approach and continue to monitor the situation.

5.7 HMRC has continued to undertake compliance activities in relation to the CIS and to monitor the construction sector; unfortunately this fraud continues. The government accepts

that most contractors and sub-contractors are only aware of the entities immediately above or below them in the supply chain, and many will undertake due diligence on those entities. But many do not, and some will act in collusion with the fraudsters.

5.8 The government has decided to explore what could be done in conjunction with larger contractors to tackle this fraud, which undermines the integrity of the UK construction sector, undercuts compliant operators to their detriment, and has a considerable negative impact on the economy.

Q12: Do you consider supply chain measures to be an appropriate response to this fraud?

Current practice

5.9 The government wants to better understand the current due diligence processes prevalent in the construction sector and welcomes responses to the following questions.

Q13: What due diligence checks do you currently undertake on your sub-contractors/suppliers?

Q14: When do you undertake these and why?

Q15: Would you consider undertaking such checks further down your supply chain? If not, why not?

Q16: What action would you take if you were not satisfied following your due diligence checks?

The proposals

5.10 As well as seeking to better understand current practice HMRC has looked at approaches to tackling supply chain fraud applied elsewhere, as suggested in the 2017 consultation responses. The proposals set out below are for early discussion with the construction sector and its representatives.

5.11 The proposals would affect larger contractors and are designed to signal that these contractors have a role to play in tackling fraud in the construction sector in conjunction with HMRC. The proposals would 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. The government is also mindful of the administrative and financial burden such proposals could impose on larger contractors, so would welcome ideas about how these could be minimised.

Site number

5.12 CIS payments and deductions reported by contractors to HMRC on monthly returns are matched to the relevant sub-contractor record. However, the payments cannot be related to specific contracts or sites, and most contractors and sub-contractors operate on multiple sites in any given period. Obtaining site information would help HMRC detect suspect entities and non-compliance in construction supply chains.

5.13 The Irish Revenue Commissioners operate a system that allows them to identify who is working on specific sites and projects. The main contractor operating on a particular site or running a major project is required to register that site or project with the Irish Tax Authority which generates a site number. Contractors are also required to provide the tax authority

with details of each construction contract they enter into with a sub-contractor. The tax authority uses this information to relay the site number to those sub-contractors working on the site or project. This number must be included on their business and individual tax returns.

5.14 Such a system would have to be adapted to suit the UK construction sector, which is much larger and currently does not require details from contractors of every contract they enter into with their sub-contractors. But should HMRC implement a similar system of site registration, it could have benefits for the site operator, workers and the tax authority. It could allow the site operator to know who is on site, in what capacity, and when to help them meet their Health & Safety and contract obligations. It could reassure workers that the site and operator is legitimate and that their payments and deductions will be correctly recorded for tax purposes. It will also help HMRC understand the supply chain and ensure all entities are compliant with their CIS obligations.

Q17: Could a site registration system work in the UK?

Reporting supply chains

5.15 HMRC could require 'main contractors', so those at the very 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 able 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.

5.16 Areas for further consideration could include:

- the definition of a 'main contractor'. Is it the entity at the top of the chain operating the CIS, or should it include large sub-contractors who also act as contractors? Is definition by reference to turnover appropriate, or should the standard definitions of very large, large and medium-sized business be used?
- how far down the supply chain should the contractor report? This could be in detail down to, say level 3 or level 5, with less detail below that;
- the checks. This could include verifying the sub-contractor 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; (confidentiality issues need to be considered as part of any further work);
- the timing of the report. The report could be made annually with the CT return; quarterly or half-yearly as an independent report; or whenever suppliers are being taken on for a new project; and
- sanctions or consequences for failing to report. Are these appropriate? If so, should there be a financial penalty or something along the lines of the 'publication of deliberate defaulters'? Could non-provision feed into the considerations around applying the Senior Accounting Officer sanctions? Should failing to fully report on time raise a risk on the main contractor's HMRC record?

Q18: How much detail is needed for these reports to be effective?

Q19: What burdens would such a process place on contractors?

Q20: How could these burdens be mitigated?

Securing losses due to fraud in the supply chain

5.17 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.

5.18 Where the fraud continues, for instance where 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.

5.19 Clear definitions would be needed of 'main contractor', 'fraud', 'losses due to fraud', and 'due diligence activities'. Other areas to explore could include:

- the timescale within which it would be reasonable to undertake due diligence activities and remove a suspect entity from the supply chain. This could vary depending on the length of the supply chain and whether HMRC is able to pinpoint the entity perpetrating the fraud and pass that information to the main contractor;
- the evidence that would satisfy HMRC that the main contractor had tried to address the fraud and so had taken reasonable steps, and so should not be penalised should it continue. The ideas set out at paragraph 5.16 under the "checks" bullet could be appropriate; alternatively the due diligence tests required to counter money laundering could apply or be suitably adapted;
- how long this payment under deduction period would last. This could depend on the seriousness of the offence and the remedies taken to address it by the contractor;
- how any tax losses due to fraud are calculated and charged on the main contractor. It might be appropriate to charge only a portion of the losses on the contractor; further mitigations could be considered based on behaviours of the contractor once a fraud has been identified and notified to them; should interest and penalties apply if the tax charged is paid late?
- appeal rights. These are serious powers that could damage a business financially and reputationally, so safeguards will be important. It may be that a warning, or even several warnings, should be the first step ahead of either preventing the contractor making payment gross or charging them for the tax lost due to fraud in their supply chain; the timing of any appeal process will also need consideration: should the appeal take place before the measures are invoked? Can the contractor continue to make payments gross during the appeal period? What might constitute adequate evidence or suspicion of fraud?

Q21: Would these two measures encourage better supply chain due diligence processes?

Q22: Do any of these supply chain proposals merit further consideration?

Q23: Do you have other ideas that could help combat fraud in construction supply chains?

Next steps

5.20 HMRC will work with the sector to further develop ideas to support supply chain due diligence in the construction sector, and the government will consult in more detail in due course.

6. Assessment of Impacts

Summary of Impacts

6.1 The government acknowledges that the measures set out in chapters 3 and 4 may impose new requirements on some businesses and have an impact on cash-flow, although this will largely affect those businesses deliberately abusing the CIS. The government is keen to understand the consequences of the changes, particularly for compliant taxpayers. The table below sets out the government’s current understanding of the impacts of these measures, excluding the supply chain proposals. The responses to this consultation will inform the final assessment.

6.2 It would be helpful if the following questions are considered in relation to the impact assessment below.

Q24: What impact will the changes have on your business?

Q25: Are there any specific impacts on small and micro businesses that are not covered in the impact assessment? If so, please provide details of the anticipated one-off and on-going costs and burdens.

Q26: Do you think these proposals will have any impacts on sub-contractors not already covered? If so, please provide details.

| Exchequer impact (£m) | 2020 -21 | 2021 -22 | 2022 -23 | 2023 -24 | 2024 - 2025 |
|---|---|----------|----------|----------|-------------|
| | +/- | +/- | 20 | 20 | 15 |
| Economic impact | <p>This measure will tighten cash-flow for those businesses who currently claim unverified CIS deductions to reduce their employer liabilities and those claiming materials deductions to which they are not entitled. Substantiated CIS deductions will be available at the year-end to set against other tax liabilities or for repayment, so the cash-flow impact in these cases will be temporary.</p> <p>The change to the deemed contractor rule is not expected to have a significant cash-flow impact on the large non-construction businesses affected.</p> | | | | |
| Impact on individuals, households and families | <p>Individual sub-contractors currently claiming a deduction for materials to which they are not entitled and are therefore not compliant will have more tax deducted in-year from their payments for construction work, but this will be available to set against their liability, or for repayment, after the end of the tax year. This could have an impact on family formation, stability or breakdown as they will have less disposable income.</p> <p>If an employer is faced with a tax bill due to over-claimed CIS deductions this could impact their cash-flow, meaning they may need to lay off some sub-contractors. These sub-contractors may have no other source of income (i.e. they only sub-contract to one company) and they would have to find another job, which could take time. This could therefore have an impact on their family formation, stability or breakdown. It could also mean that small companies with just one</p> | | | | |

| | |
|---|--|
| | <p>employee, or those who are self-employed, could go out of business, which could have a significant impact on their family formation, stability and breakdown. The impact will depend on the amount of income lost and their personal circumstances.</p> <p>Customer experience is expected to stay broadly the same for compliant individuals because they will not need to make any changes to continue to meet their obligations under the CIS.</p> <p>We will use the consultation to identify any additional impacts on individuals and their families.</p> |
| Equalities impacts | <p>This measure targets those working in construction or commissioning construction work, some of whom are also employers. Sub-contractors are a largely male population. The measure is targeted at those breaking the rules and will affect all these businesses equally.</p> <p>It is not anticipated that this will impact on other groups with protected characteristics.</p> |
| Impact on businesses and Civil Society Organisations | <p>This measure is not expected to have significant impacts on compliant businesses or civil society organisations. Those businesses claiming CIS deductions on their employer returns that cannot be substantiated by HMRC will need to provide evidence of those deductions to HMRC or self-correct their returns. These two tasks could increase the administrative burden on otherwise compliant businesses.</p> <p>Where businesses cannot provide the required evidence and do not self-correct their employer returns HMRC will correct the CIS deductions set-off amount. In most cases this will increase the employer liabilities due for payment and could affect cash-flow or lead to payment difficulties and possibly some business failures. Substantiated CIS deductions will be available to these employers at the year-end either to set against other tax liabilities or for repayment, so the cash-flow impact is one of timing only.</p> <p>The change to the deemed contractor rules may mean more non-construction businesses having to operate CIS with its associated administrative tasks. It was always intended such businesses should operate CIS so these are not strictly new burdens rather tasks they should have been carrying out in the past.</p> <p>Customer experience could be negatively impacted for those compliant businesses who may have to provide additional information to HMRC to confirm compliance with the CIS rules.</p> |
| Impact on HMRC or other public sector delivery organisations | <p>There will be both IT and resource costs for HMRC in developing, applying and policing this measure.</p> |
| Other impacts | <p>Other impacts have been considered and none have been identified.</p> |

7. Summary of Consultation Questions

This consultation asks for your views on the following questions.

Q1: Are there other circumstances where HMRC should allow an employer to claim CIS set-offs later in a tax year following HMRC correction of an EPS return?

Q2: Do you have any comments on the interest and penalty consequences of HMRC making these corrections to an EPS return?

Q3: Are there other sources of evidence HMRC should accept as proof that a CIS deduction on account of tax has been made?

Q4: Do you have any comments on HMRC being able to disregard certain evidence in deciding to use the correction power?

Q5: Is 14 days the right amount of time for the employer to provide evidence of CIS deductions suffered?

Q6: Is 14 days the right amount of time for the employer to correct the return?

Q7: If not, what timescale do you suggest?

Q8: Does this review and appeal process provide adequate protection for sub-contractors making errors?

Q9: Should other safeguards be considered in relation to these powers? If so, what should those safeguards be?

Q10: Are there other options to disallow CIS deductions claimed on an EPS return that are not supported by satisfactory evidence?

Q11: Do you have other ideas that could protect the CIS from abuse?

Q12: Do you consider supply chain measures to be an appropriate response to this fraud?

Q13: What due diligence checks do you currently undertake on your sub-contractors/suppliers?

Q14: When do you undertake these and why?

Q15: Would you consider undertaking such checks further down your supply chain? If not, why not?

Q16: What action would you take if you were not satisfied following your due diligence checks?

Q17: Could a site registration system work in the UK?

Q18: How much detail is needed for these reports to be effective?

Q19: What burdens would such a process place on contractors?

Q20: How could these burdens be mitigated?

Q21: Would these two measures encourage better supply chain due diligence processes?

Q22: Do any of these supply chain proposals merit further consideration?

Q23: Do you have other ideas that could help combat fraud in construction supply chains?

Q24: What impact will the changes have on your business?

Q25: Are there any specific impacts on small and micro businesses that are not covered in the impact assessment? If so, please provide details of the anticipated one-off and on-going costs and burdens.

Q26: Do you think these proposals will have any impacts on sub-contractors not already covered? If so, please provide details.

8. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stages 1 and 2 of the process. The purpose of the consultation is both to seek views on the framework for implementation of the measures set out in chapters 3 and 4, as well as identifying options and seeking views on those set out in chapter 5.

How to respond

Responses should be received by 28 May 2020, by email to: cisconsultations@hmrc.gov.uk, or by post to: Stephanie Allistone

Tax Administration Policy & Strategy Team
HM Revenue & Customs
Floor 5, 1 Ruskin Square
CROYDON CR0 2WF

A summary of the questions in this consultation is included at chapter 7.

Please do not send consultation responses to the Consultation Coordinator.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes.

These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018, General Data Protection Regulation (GDPR) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply

and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs.

Consultation Privacy Notice

This notice sets out how we will use your personal data, and your rights. It is made under Articles 13 and/or 14 of the General Data Protection Regulation.

Your Data

The data

We will process the following personal data (*delete/add as appropriate*):

Name

Email address

Postal address

Phone number

Job title

Purpose

The purpose(s) for which we are processing your personal data is: Tackling CIS Abuse.

Legal basis of processing

The legal basis for processing your personal data is that the processing is necessary for the exercise of a function of a government department.

Recipients

Your personal data will be shared by us with HM Treasury.

Retention

Your personal data will be kept by us for six years and will then be deleted.

Your Rights

- You have the right to request information about how your personal data are processed, and to request a copy of that personal data.
- You have the right to request that any inaccuracies in your personal data are rectified without delay.
- You have the right to request that any incomplete personal data are completed, including by means of a supplementary statement.
- You have the right to request that your personal data are erased if there is no longer a justification for them to be processed.
- You have the right in certain circumstances (for example, where accuracy is contested) to request that the processing of your personal data is restricted.

Complaints

If you consider that your personal data has been misused or mishandled, you may make a complaint to the Information Commissioner, who is an independent regulator. The Information Commissioner can be contacted at:

Information Commissioner's Office
Wycliffe House
Water Lane
Wilmslow
Cheshire
SK9 5AF
0303 123 1113
casework@ico.org.uk

Any complaint to the Information Commissioner is without prejudice to your right to seek redress through the courts.

Contact details

The data controller for your personal data is HM Revenue and Customs. The contact details for the data controller are:

HMRC
100 Parliament Street
Westminster
London SW1A 2BQ

The contact details for HMRC's Data Protection Officer are:

The Data Protection Officer
HM Revenue and Customs
7th Floor, 10 South Colonnade
Canary Wharf, London E14 4PU
advice.dpa@hmrc.gsi.gov.uk

Consultation Principles

This consultation is being run in accordance with the government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website:
<http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue and Customs, 100 Parliament Street, London, SW1A 2BQ.

Please do not send responses to the consultation to this address.

Annex A – Legislation

The Construction Industry Scheme rules are set out in Chapter 3 and Schedules 11 & 12 Finance Act 2004 (FA04), and in the Income Tax (Construction Industry Scheme) Regulations 2005 (SI2005/2045).

Links to these provisions on the legislation website are provided below.

<http://www.legislation.gov.uk/ukpga/2004/12/contents>

<http://www.legislation.gov.uk/uksi/2005/2045/contents/made>

This consultation document refers specifically to:

Section 59(1)(l) and section 59(3) FA04 – the ‘deemed contractor’ test;

Section 61 FA04 – deduction on account of tax from contract payments;

Section 61(1) FA04 – the ‘materials deduction’ rule;

Section 72 FA04 – penalty for providing false information when registering for the CIS;

Section 74 FA04 – the meaning of ‘construction operations;’

Regulation 17 SI 2005/2045 – in-year repayments of provisional excess credit; and

Regulation 56 SI 2005/2045 – application by the Commissioners of sums deducted under section 61.

The recovery provisions referred to at paragraph 3.6 are set out below:

Regulation 9 SI 2005/2045 – recovery from sub-contractor of amount not deducted by contractor.

The problem concerns excess or erroneous claims for deductions being set against employer liabilities and this provision only covers contractor liability if deductions are not made.

Regulation 13 SI 2005/2045 – determination of amounts payable by contractor.

This provision applies to contractors rather than sub-contractors.

Section 70A FA04 (and Part 3A SI 2005/2045) - power to require security for payments to HMRC.

This provision applies only to contractors and not to sub-contractors.

Regulation 80 of the PAYE Regulations (SI 2003/2682) - determination of unpaid tax.

There are difficulties in identifying which employer liabilities are underpaid due to a CIS set-off, and making a determination under this provision would provide a solution only for any PAYE tax underpaid, whereas the CIS set-off could cover NICs, statutory payments, student loan repayments, etc;

Section 8 Social Security Contributions (Transfer of Functions) Act 1999 SSC(TF)A 1999 - decisions by officers of Board.

Most NICs decisions require HMRC to identify the individual contributor and calculate the contributions underpaid by each in order to protect their entitlement to benefits, allowances and the state pension. Having to undertake that work, possibly several years after the payments have been made, is onerous both for HMRC and the employer.

Even if HMRC could effectively make use of any of the provisions above there is nothing to stop the employer from simply reclaiming the sums secured on a later EPS return.

The PAYE and NICs legislation mentioned above can be found at the links below.

<http://www.legislation.gov.uk/search?title=&year=2003&number=2682&type=uksi>

<http://www.legislation.gov.uk/primary/1999?title=Social%20Security%20Contributions%20%28Transfer%20of%20Functions%29%20Act>