

EXPLANATORY MEMORANDUM TO
THE INCOME TAX (CONSTRUCTION INDUSTRY SCHEME) (AMENDMENT)
REGULATIONS 2021

2021 No. 321

1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 The Construction Industry Scheme (CIS) sets out the rules for how contractors are required to make appropriate deductions from payments to sub-contractors, then pay the deductions to HMRC. Sub-contractor companies that have had CIS deductions made from contract payments made to them by contractors are entitled to set those deductions against their employer liabilities, such as Pay As You Earn (PAYE) tax or National Insurance contributions (NICs), under the Real Time Information (RTI) system for PAYE. HMRC is aware that this set-off facility is being abused by some employers to reduce their monthly employer liabilities or to create spurious repayment claims.
- 2.2 To tackle this abuse, this instrument will allow officers of HMRC to correct or remove CIS set-off claims made on RTI returns where such claims are made on the basis of an error or omission, and also prohibit sub-contractors, in some cases, from making further set-off claims for the remainder of a particular tax year. The rules on the costs of materials directly incurred by sub-contractors to fulfil a construction contract are also being clarified. The changes in this instrument will take effect from 6 April 2021.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 This instrument contains the first exercise of a new power to make regulations authorising an officer of HMRC to correct an error or omission relating to a set-off claim, remove a set-off claim or prohibit a person from making a further set-off claim. This power will be contained in section 62 of the Finance Act 2004 and has been given temporary statutory effect pursuant to Budget resolution number 27 passed by the House of Commons and recorded in the House of Commons Votes and Proceedings for 9 March 2021, that it is expedient that the provision should have statutory effect, under section 1(3) to (5) of the Provisional Collection of Taxes Act 1968.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 Chapter 3 of Part 3 of the Finance Act 2004 (“the 2004 Act”) is the principal legislation relating to the CIS. It sets out the rules for how payments to sub-contractors for construction operations must be handled by contractors in the construction industry and has operated in some form since the 1970s. Section 62(3) of the 2004 Act provides that, if a sub-contractor is a company, a sum deducted under section 61 of the 2004 Act and paid to HMRC is to be treated, in accordance with regulations, as paid on account of any relevant (employer) liabilities of the sub-contractor. A company operating in construction is entitled to make set-off claims if, either, they are not registered as a sub-contractor at all under the legislation, so are liable for deductions from contract payments at a prescribed higher rate, which is currently 30% of the payment; or are registered for payment under deduction as a sub-contractor under section 63(3) of the 2004 Act, so are liable for deductions from contract payments at a separate prescribed rate, which is currently 20% of the payment.
- 6.2 The Income Tax (Construction Industry Scheme) Regulations 2005 (S.I. 2005/2045) (“the 2005 Regulations”), made under the vires of the 2004 Act, set out the detailed rules for how contract payments to subcontractors for construction operations must be handled by contractors operating in the CIS, and certain other businesses. Regulation 56 of the 2005 Regulations provides for the order in which any sums deducted by contractors from contract payments made to a sub-contractor which is a company may be applied against various relevant liabilities. This instrument amends the 2005 Regulations in order to provide for additional and amended rules in consequence of paragraph 6 of Schedule 6 to, the Finance Bill 2021.
- 6.3 Part 1 of this instrument provides for citation, commencement and effect and defines certain key terms. Part 3 of this instrument inserts a new Part 4A (regulations 24A to 24M) into the 2005 Regulations which will enable an officer of HMRC to correct or remove a set-off claim which has been made by a PAYE employer in order to set off CIS deductions made from their contract payments against relevant liabilities. It will also enable officers to prohibit sub-contractors under the CIS from making further set-off claims within a particular tax year if a set-off claim has been corrected or removed by HMRC during that tax year. The instrument provides for: the service of a notice on a claimant to provide evidence to support their set-off claim; how the correction or removal of a set-off claim or a prohibition can be revoked if HMRC has made an

error; and how claimants can appeal these decisions taken in respect of their set-off claims. The new Part 4A of the 2005 Regulations will have effect in relation to any set-off claim which is contained in an employer return submitted on or after 6 April 2021 and relates to the tax year 2021-22 or to a subsequent tax year.

- 6.4 Part 2 of this instrument makes consequential amendments to the 2005 Regulations to take into account amendments to Chapter 3 of Part 3, which are intended to clarify that only the direct cost of materials incurred by a sub-contractor to fulfil a particular construction contract will be deductible from the overall contract payment from which a contractor must deduct the prescribed percentage. The amendments contained in Part 2 will have effect in relation to any direct costs to a sub-contractor of materials used or to be used to carry out a construction operation, where the costs are incurred on or after 6 April 2021.
- 6.5 This instrument will have effect for the tax year 2021-22 and subsequent tax years and will come into force on 6 April 2021.

7. Policy background

What is being done and why?

- 7.1 HMRC is aware that the CIS set-off process is being abused by entities who are not entitled to make set-off claims. In some cases, limited companies which are not sub-contractors operating under the CIS are falsely claiming that they have had CIS deductions made from payments to them so they can set off the claimed CIS deductions against their employer liabilities. In some cases, sub-contractors operating under the CIS, but who are not companies, are attempting to set off CIS deductions made from their contract payments against employer liabilities, although they are not entitled to do so under section 62 of the 2004 Act. Equally, sub-contractors who operate under the CIS, but are registered for gross payment under section 70 of the 2004 Act (and so do not have any CIS deductions made from contract payments made to them) are making false set-off claims to try and set off the claimed CIS deductions against their employer liabilities. Finally, sub-contractors which are companies and so entitled to make set-off claims in general are claiming higher figures of CIS deductions than those that have been made from contract payments to them.
- 7.2 The 2005 Regulations, the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) (“the PAYE Regulations”) and the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) all contain various provisions designed to allow HMRC to secure payment of sums not declared or not paid over by the employer or contractor. However, the existing legislation does not allow HMRC to quickly and effectively correct or remove CIS set-off claims containing an error either during, or following the end of, a tax year.
- 7.3 The new power to be inserted into section 62 of the 2004 Act by Finance Bill 2021, and which has been given temporary statutory effect by Budget resolution number 27, allows HMRC to make regulations which enable an officer of HMRC to correct the CIS deductions figure specified on a set-off claim. Where there is no satisfactory evidence to support a set-off claim being made in that figure, an officer can remove the claim altogether if there is no evidence that the claimant should have made it, whether because they are a sub-contractor who did not have any CIS deductions made during the tax period in question or because they were not entitled to make a set-off claim in the first place. New subsection (3C) to be inserted into section 62 provides

that a “set-off claim” means a claim for treating a sum deducted under section 61 of the 2004 Act as paid on account of any relevant liabilities. Set-off claims, which are made on an RTI employer return, will include a claim figure calculated by the person making the claim.

- 7.4 This instrument allows an officer of HMRC to correct or remove a set-off claim in certain cases. Evidence which HMRC will look at in order to determine the correct figure of CIS deductions which should have been claimed for a tax period will include, in particular, monthly returns submitted to HMRC by contractors under regulation 4(1) of the 2005 Regulations. Before HMRC takes these steps in relation to a sub-contractor operating under the CIS, that sub-contractor will have an opportunity to provide evidence to HMRC upon receipt of a notice to provide information, and a further opportunity to correct or remove their own set-off claim. Even if an officer of HMRC reasonably believed that a set-off claim was made in error, if a sub-contractor can provide evidence in support of that claim, HMRC will allow the set-off claim and will not take any further action in respect of that claim. HMRC will also be limited to correcting or removing set-off claims made by sub-contractors either within the tax year in which the set-off claim was made, or in respect of an earlier tax year, provided that the tax period in respect of which the set-off claim was made falls within the preceding three tax years. This is intended to align with the requirements for sub-contractors to retain records relating to the three preceding tax years, contained at regulations 51 and 52 of the 2005 Regulations.
- 7.5 This instrument will also enable HMRC to prohibit a sub-contractor from setting further CIS deductions against their employer liabilities for the rest of the same tax year where the correction power has been used. This instrument provides for procedural requirements in relation to the giving of information by sub-contractors, and the service of notices by officers of HMRC.
- 7.6 Where HMRC corrects or removes a set-off claim made by a sub-contractor operating in the CIS, or prohibits a sub-contractor from making further set-off claims for the remainder of a tax year on this basis, there will be a right of appeal to a tribunal against that decision. There will also be a right of appeal to a tribunal where HMRC removes a set-off claim on the basis that it was made by an employer who is not eligible to make set-off claims because they are not a sub-contractor, in cases where HMRC does not subsequently revoke that decision. The ordinary rules on reviews and appeals contained in Part V of the Taxes Management Act 1970 will apply to these appeals, with some exceptions. Where HMRC removes a set-off claim made by an employer who is not eligible to make set-off claims because they are not a limited company, or because the employer is registered for gross payment so does not have any CIS deductions made from their contract payments, there will be no right of appeal available to the employer. This is because HMRC can definitively and independently establish eligibility to make set-off claims for these groups of employers through evidence available from HMRC records and those of Companies House; whereas HMRC records, in some exceptional circumstances, may not accurately reflect whether an employer is a sub-contractor. In a case where HMRC makes a mistake by removing a set-off claim, this instrument provides for a power for an officer of HMRC to revoke that decision. Finally, this instrument makes provision as to the date when late payment interest will accrue on any additional sums of PAYE tax or NICs which may become payable as a result of a correction or removal of a set-off claim.

- 7.7 Finally, some contractors and sub-contractors are interpreting the CIS rules to mean every sub-contractor in a chain working on the same overarching construction project can take a deduction under section 61 of the 2004 Act for materials used during the project, even if they did not directly pay for those materials. The amendments made by paragraph 4 of Schedule 6 to, the Finance Bill 2021 (changes will clarify the policy intention that deductions for materials are only available to sub-contractors who directly incurred those costs. Various consequential changes have been made to the 2005 Regulations by this instrument to give effect to this clarification).
- 7.8 These changes will tackle abuse of the CIS rules, and help to ensure a level playing field for compliant construction businesses, ensuring that only those deductions which sub-contractors are entitled to are set off against employer liabilities, and that the CIS rules cannot be manipulated. The changes do not increase the tax burden on the construction sector.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

- 8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

- 9.1 There are currently no plans to consolidate the instrument that is being amended.

10. Consultation outcome

- 10.1 The issues which the legislation in this instrument addresses, have been subject to consultation. A consultation document entitled, *Tackling Construction Industry Scheme Abuse*, was published on 19 March 2020¹ and closed on 28 August 2020. A response document was published on 12 November 2020². An eight-week technical consultation on the draft primary legislation, to be included in the Finance Bill 2021, was published on the 12 November and closed on 7 January 2021.
- 10.2 The purpose of the March 2020 consultation was to seek views on the proposed changes to tackle CIS abuse and prevent tax loss. The consultation asked a number of questions designed to seek views on the power that will enable HMRC to correct the amount of CIS deduction claimed on a sub-contractor's employer return where HMRC identify or suspect inaccurate amounts have been claimed.
- 10.3 HMRC received 34 written responses to the consultation and held four roundtable meetings with external stakeholders. Although some respondents explained that the timeframe to provide evidence of CIS deductions suffered and the timeframe to correct an employer return would be challenging, most of the respondents broadly welcomed the proposals. Minor changes were made to this instrument in view of responses received to the consultation, including providing HMRC officers a level of discretion to agree, on a case by case basis, an extended timeframe with the sub-contractor to provide suitable evidence. Technical consultations on the draft primary and secondary legislation resulted in six responses to the primary legislation and three

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/873595/Consultation_Tackling_Construction_Industry_Scheme_abuse.pdf

²https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934590/Tackling_Construction_Industry_Scheme_abuse_-_summary_of_responses.pdf

responses to the secondary legislation. Broadly, most of the respondents welcomed the changes introduced.

11. Guidance

- 11.1 Guidance for sub-contractor employers operating under the CIS has been published on gov.uk website and is available at: <https://www.gov.uk/government/publications/construction-industry-scheme-cis-340/construction-industry-scheme-a-guide-for-contractors-and-subcontractors-cis-340#appa>. Guidance will be updated to reflect the changes to the CIS rules by 6 April 2021.

12. Impact

- 12.1 There is no, or no significant, impact on business, charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax Information and Impact Note covering this instrument was published on 12 November 2020 alongside draft primary legislation and Explanatory Note and is available on the website at: <https://www.gov.uk/government/publications/changes-to-tackle-construction-industry-scheme-abuse>. It remains an accurate summary of the impacts that apply to this instrument.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to update guidance and to ensure it is clear and accessible.
- 13.3 The basis for the final decision on what action to take to assist small businesses, is to enable fair compliance with the CIS rules. The changes will ensure HMRC can act quickly where the rules are being broken and so level the playing field for all those operating within construction. The changes do not increase the tax burden on the construction sector.

14. Monitoring & review

- 14.1 The approach to monitoring of this legislation is to consider the effectiveness of the amendments made by this instrument to ensure that the government's objectives are met. This will be done by continued communication with affected taxpayer groups and external stakeholder groups, including members of HMRC's Construction Forum.
- 14.2 The regulation does not include a statutory review clause because of a tax exemption in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

- 15.1 Joanna Were at HMRC Telephone: 03000 590559 or email: joanna.were@hmrc.gov.uk can be contacted with any queries regarding the instrument.
- 15.2 Helen Page, Deputy Director for Tax Administration Policy and Strategy, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 The Rt Hon Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.