

CIS - A New Dawn

In April 2003, Gordon Brown announced changes to the Construction Industry Scheme (CIS). The changes were originally due to take effect in April 2005 but were deferred initially to April 2006 and, at the eleventh hour, to April 2007. There is clearly a lot to think about before April 2007. The new system places great emphasis on contractors' procedures and backs this up with automatic penalties.



Under the new scheme the Revenue will be placing great emphasis on automatic penalties for late returns, failure to provide records or payslips etc but also a monthly emphasis on the employed/self-employed position of the subcontractors. If contractors get this wrong, once again penalties may apply.

This bulletin focuses on the main areas requiring consideration over the coming months. There are some fundamental issues which need to be considered prior to April 2007.

No vouchers

Under the new CIS, from April 2007 all of the old vouchers such as the CIS23, CIS24 and CIS25 will become redundant. In addition, the annual CIS return will also be scrapped. This at first appears to be an advantage of the new scheme.

However, the current requirements will be replaced by a monthly return. Contractors will have to make a **monthly** return to the Revenue:

- confirming that the employment status of subcontractors has been considered
- confirming that the new verification process has been correctly dealt with
- detailing payments made to all subcontractors and
- detailing any deductions of tax made from those payments.

The monthly return can be sent either manually or electronically and will relate to each tax month (ie running from the 6th of one month to the 5th of the next). The deadline for submission is 14 days after the end of the tax month. Even if no subcontractors have been paid during a month, contractors will still have to make a nil return. All contractors will be obliged to file monthly even if they are entitled to pay their PAYE quarterly.

No CIS cards

From April 2007 there will be no registration cards or tax certificates. Instead subcontractors must give contractors their name, unique taxpayer reference

and national insurance number (or company registration number) when they enter into a contract. So long as the contractor is satisfied that the subcontractor is genuinely self-employed the 'verification' procedure (explained overleaf) must be followed.

Employed or self-employed?

A key part of the new regime will be that the contractor has to make a monthly declaration that they have considered the status of the subcontractors and are satisfied that none of those listed on the return are employees. The Revenue have decided to back this up with a penalty of up to £3,000 if contractors negligently or deliberately provide incorrect information.

Remember that employment status is not a matter of choice. The circumstances of the engagement determine how it is treated.

The issue of the status of workers within the construction industry is not a new matter and over the last two years the Revenue have been making substantial efforts to re-classify as many subcontractors as possible as employees. The courts have considered many cases over the years and take into account a variety of different factors in deciding whether or not a worker is employed or self-employed. The tests which are applied include:

- the right of control over how, what, where and when the work is done; the more control that a contractor can exercise, the more likely it is that the worker is an employee
- whether the worker provides a personal service or whether a substitute could be provided to do that work
- whether any equipment is necessary to do the job and, if so, who provides it
- the basis of payment - whether an hourly/weekly rate is paid, whether there is any overtime, sick or holiday pay and whether or not invoices are raised for the work done

- whether the worker is part and parcel of the organisation or whether they are conducting a task which is self-contained in its own right
- what the intention of the parties is - whether there is any written statement that there is no intention of an employment relationship
- whether there is a mutuality of obligation; that is, an ongoing understanding that the contractor will offer work and the worker accept it
- whether the workers have any financial risk.

As can be seen from the above, there are a number of factors which must be considered and the decision as to whether somebody should be classified as employed or self-employed is not a simple one.

Clearly, the Revenue would like subcontractors to be classed as employees, as this generally means that more tax and national insurance is due. However, just because the Revenue think that somebody should be re-classified does not necessarily mean that they are correct.

It is interesting that the Revenue have developed software to address this matter but the software appears to be heavily weighted towards re-classifying subcontractors as employees. It should not be relied on and professional advice should be taken if this is a major issue for your business. Please talk to us as a matter of urgency if you have any particular concerns in this area.

Verification

The contractor will have to contact the Revenue to check whether to pay a subcontractor gross or net. Not every subcontractor will need verifying. Usually it will only be new ones.

The verification procedure will establish which of the following payment options apply:

- gross payment
- a standard rate deduction of 18%, which is the current rate of deduction
- a deduction made at the higher rate (yet to be announced but possibly around 30%) if the subcontractor has not registered with the Revenue or cannot provide accurate details to the contractor and the Revenue cannot verify them.

The Revenue will give the contractor a verification number for the subcontractors which will be matched with the Revenue's own computer. The number will be the same for each subcontractor verified at any particular time. There will be special numbers for subcontractors who cannot be verified. The numbers will have to appear on contractors' monthly returns and payslips.

Clearly, these numbers are a fundamental part of the new system and contractors will have to ensure that they have a fool-proof system in place for obtaining and retaining them. It will also

be very important to give precise details to the Revenue because, if their computer does not recognise the subcontractor, the higher rate deduction will have to be made.

A payslip?

Contractors will have to provide a monthly 'payslip' to all subcontractors paid, showing the total amount of the payments and how much tax, if any, has been deducted from those payments. The contractor will have to provide this for each tax month as a minimum. Contractors will be allowed to choose the style of the 'payslips' themselves but certain specific information will have to be provided including:

- the contractor's name
- the contractor's employers' tax reference
- the tax month to which the payment relates
- the subcontractor's name, unique tax reference or specific subcontractor reference
- the gross amount of the payment
- the cost of any materials which have reduced the gross payment and
- the amount of any deductions.

It may well be that contractors want to include such payments as part of their normal payroll system. However, if this option is chosen, it will need to be clear that although payslips are being generated for those individuals, they are not employees and have clearly been classed as self-employed.

Penalties

The whole system is backed up by a series of penalties. These cover situations in which an incorrect monthly return is sent in negligently or fraudulently, failure to provide CIS records for the Revenue to inspect and incorrect declarations about employment status. However, two further penalties will be much more common on a day-to-day basis:

- for failure to send in the monthly return there will be a penalty of £100 per 50 subcontractors (or part thereof) per month
- for failure to provide a subcontractor with a 'payslip', a penalty of up to £300, plus a further penalty of up to £60 per day for continuing failure.

Clearly procedures and controls will be vital in avoiding these penalties.

Paying over the deductions

Contractors will have to pay over all deductions made from subcontractors in any given tax month by the 19th following the end of the tax month to which the deductions relate. If payment is being made electronically, the date will be the 22nd, or the next earlier banking day when the 22nd is a weekend or holiday. If the

contractor is a company which itself has deductions made from its payments as a subcontractor, then the deductions made may be set against the company's liabilities for PAYE, NI and any CIS deductions it is due to pay over.

What about subcontractors?

There will be transitional rules for subcontractors currently within CIS. A subcontractor under the existing CIS may not need to register under the new CIS if they have:

- a tax certificate (CIS5 or 6)
- a permanent registration card (CIS4(P))
- a temporary registration card (CIS4(T)) that has not expired.

However, if a subcontractor first starts working in the construction industry on a self-employed basis after 5 April 2007, or had a temporary registration card that has expired, they will need to register for the new CIS.

To register, a subcontractor will need to contact the Revenue by phone or over the internet and they will conduct identity checks. The rules for subcontractors to be paid gross are broadly equivalent to the current rules. There will be a business test, a turnover test and a compliance test similar to the existing regime.

Subcontractors not registered with the Revenue will suffer the higher rate deduction from any payments made to them by contractors.

What to do now

Things to think about include:

- reviewing the self-employment status of existing subcontractors
- reviewing computer systems/payroll systems to ensure that the monthly 'payslip' can be generated in the required format
- ensuring that advice and training is undertaken to ensure a good understanding of the self-employment tests
- ensuring that systems are put in place to cope with the verification process, payment process and monthly return process.

We are here to help you. Please talk to us to discuss the practicalities of implementing the systems that will be required to avoid the automatic penalties under the new regime.