Construction Industry Scheme

Guidance and Commentary

2nd edition

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10. Materials

10.1 Introduction

Within CIS, if a subcontractor provides and charges for materials as part of the service to the contractor, the intention is for that proportion of the charge not to include a profit margin and for it to be excluded from any calculation of tax to be deducted. Suppliers of materials with no labour element are excluded entirely from any CIS reporting requirements. This includes delivery to site or business premises.

10.2 Who does this affect?

For subcontractors with gross payment status, this is not an issue. All that is paid to them is done so without any need for distinguishing what element is for materials, labour, expenses or profit.

For net paid labour-only subcontractors, the whole amount of any payments is subject to deduction, irrespective of any expenses incurred.

Those providing professional services, defined as architects and surveyors, are exempt from CIS in any event unless their remit extends to become that of developers. Any time spent by other subcontractors in trying to interpret exactly what is needed on site, may not be classed under this heading.

That leaves the net paid subcontractors whose services include the cost of materials and the provision of plant as well as labour. Those businesses need to show separately on their invoices (or applications), the part of the total that is subject to deduction and that which is not. But how do they arrive at that deduction-exempt proportion?

Some simply do not bother. They accept the deduction of tax on the whole payment as a savings scheme for SA tax, or offset it against PAYE/NI/CIS liabilities due. Such businesses may have a mixture of net-paid industry work and gross-paid domestic work, so deductions are less of an issue. However, given the cash flow difficulties of many businesses involved in construction, parking

this money up to be set against a payment months in advance that may not even be payable, is not a viable option.

Therefore, for that business to minimise its tax deduction legitimately, or to make the correct calculation of the proportion of a charge that is not subject to tax deduction – which is classified for CIS as materials – how should that be calculated?

10.3 Definition of materials

If actual building materials are provided as part of the subcontractor's service to the contractor, then according to HMRC, the amount not subject to CIS deduction should be the actual cost of those materials to the subcontractor. But that rather naively assumes that the subcontractor provides – or has delivered to site – materials for which can be produced one or more invoices arriving at exactly the amount charged for.

That may indeed be the case if a particular shade of paint, or type of cladding or roofing material, has been specified by the end client. But for such things as plasterboard, carpet underlay or cabling, the subcontractor will buy these in large quantities, to be used in several projects. If the price of copper pipe goes up, should the subcontractor include the price of the stock held when the job was priced, or the cost when it was installed – if he can remember which was used in this particular job?

If some remnant stock from an earlier job is used, should that be charged at the unit cost per the invoice, or at nil given that the whole cost may have been recovered in that earlier job?

Hold that thought for a minute. What HMRC wish to avoid are abuses of the scheme by subcontractors, who may be tempted to inflate the cost of materials so as to reduce the tax deduction artificially. A plasterer's charge to a contractor should not include 90% for materials.

So as long as the materials element is "sensible", no consequences should arise. This has not prevented HMRC from raising some rather semantic arguments. Indeed, in CIS340 the responsibility is placed on the contractor.

It says, the contractor "can ask for evidence of the direct cost of materials" – without defining what is evidence. Without provision of

this evidence, the contractor must make a fair estimate of the actual cost of the materials.

The guidance in CIS340 does not spell out what the contractor should do with this evidence. Presumably, as with the declaration of consideration of self-employment in the monthly CIS return authorisation, the contractor should satisfy himself that all is well. But how can that be proved to an inspector?

10.4 Policing of materials

CIS340 states that if the materials element "looks excessive", an explanation may be sought by HMRC. How can a tax inspector that has never worked in construction determine what is excessive?

If a subcontractor has taken too long for the work or has made errors that created costs for the contractor, should any deduction be made from the materials element or (more likely) the due-for-tax-deduction element? This often happens, so if the ratio shifts from 50:50 of materials/labour to 80:20 because of that reduction in authorised payment, is the HMRC inspector then going to penalise the contractor?

The best defence for the contractor in this situation would be to ask that the inspector proves that the tax and accounting treatment was reckless, and the evidence for arriving at that conclusion; also to ask how much tax was lost to Treasury as a consequence and to ask for a Regulation 9(5) finding (see **Chapter 14** for more details). Unless the materials were ludicrously overstated, it would be a brave inspector that took such a case to a Tax Tribunal.

HMRC have been quite assertive in this area recently. Contractors have been asked to evidence the deductions for materials, insofar as copies of invoices have been requested. Nowhere in CIS340 is it suggested that contractors should ask for this from their subcontractors. Whilst this might be a good idea (should this be practicable), it is just more time to be spent on compliance by the contractor. As mentioned in **Chapter 14**, this is something else in which HMRC can be asked to exercise their powers under Schedule 36 of FA 2008 – in other words, to ask the subcontractor to justify his figures but under the principle in CIS Manual 83050 that HMRC should not recover more tax than is correctly payable.

10.5 Other deductions to be included with materials

A subcontractor may include with materials, cost of plant hire. That is, actual costs charged by third parties for the provision of plant including fuel for its operation and presumably, though not stated, any costs for the delivery of that plant to site.

What may not be included is any charge for plant that the subcontractor owns. Therefore a net paid scaffolding firm must suffer full deduction of tax from its payments unless any poles or other equipment are hired in. HMRC make no recognition of the fact that scaffolding boards have a limited life and may not be repaired.

One complication that can be raised is when a plant hire company provides an operator with the item of plant. If the invoice simply specifies plant hire, then it can be regarded as such, not least because the hiring company is unlikely to be CIS registered and would be unhappy at having tax deducted. But what happens when the plant hire invoice indicates a labour charge as part of the overall cost? Is that merely a breakdown of the cost or is the company asking for tax to be deducted from that element of the cost? In CISR14240, there is a direct reference to plant hire with operator for use on site, as being an integral part of construction. Therefore the plant hire company needs to be verified, the whole of the cost should be processed by the contractor of that service through CIS, with the non-labour element treated as materials and the labour element subjected to tax unless the hirer has GPS.

Other than plant hire, that is it. All other costs sustained by the subcontractor must be met from the net sums received.

10.6 No recognition of materials

If a subcontractor invoices a contractor and shows – correctly – part of the charge as being for plant hire, the contractor may ignore this and apply the tax deduction to the whole of the payment. What should the subcontractor do?

As this pertains to an incorrect deduction, as covered in **Chapter 14**, the options are to accept the position and redeem the tax later, to ask the contractor to correct the deduction or to apply to HMRC with the details of the excessive deduction. The only difference here is that HMRC may refuse on the basis that the contractor has made

what was felt to be a necessary correction. The time and effort to argue the point may not be worth the outcome.

10.7 Test cases

The contractor cannot simply contend that the materials element of an invoice looks correct and then insist that such satisfaction is its own evidence. This was the principal tool used in *Flemming*, to question an HMRC assessment based on excessive statement of materials; in the absence of any other evidence, the FTT upheld the assessment.

The issue of exemptions for travel expenses was not fully explored in *Refit Shopfitting Services*; on the face of it, these should not be exempt from deduction, but HMRC granted a reg. 9 direction. Claiming such a direction, as with failure to deduct tax from labour costs, should be a defence to negotiate with HMRC before going to FTT, especially if the subcontractor will co-operate.

Lack of knowledge of CIS, leading to the acceptance of material costs stated (as plant and other expenses) can be costly – the contractor lost heavily in *Doocey* in such a situation. This emphasises the need to ensure that staff dealing with CIS understand its complexities. This can occur in small contractor firms, or much larger companies such as *Maypine*.

It would be of benefit for accountants to talk to their construction clients about their procedures for invoice authorisation, to prevent such costs occurring.

Cases: *Refit Shopfitting Services v HMRC* [2012] UKFTT 42 (TC); *Flemming & Son Construction (West Midlands) v HMRC* [2012] UKFTT 205 (TC); *Doocey North East v HMRC* [2014] UKFTT 863 (TC); *Maypine Construction Ltd v HMRC* [2017] UKFTT 833 (TC)

Index of cases

AE Joiners Ltd v HMRC [2011] UKFTT 672 (TC) 16.3
AGD Joiners Ltd v HMRC [2014] UKFTT 790 (TC) 16.3
Alpine Contract Service Ltd v HMRC [2016] UKFTT 394 (TC) 16.3, 17.3.2
Arnold (HMRC) v G-Con Ltd [2005] & [2006] EWCA Civ 829 ....16.2.2; 17.2.4
ASM (Refurbishments & Decorators) Ltd v HMRC [2016] UKFTT 822 (TC) 16.3, 17.3.4
Austin v HMRC [2010] UKFTT 312 (TC) 16.3; 17.3.4
B&I Plastering v HMRC [2015] UKFTT 587 (TC) 16.3, 17.3.4
Bannister Combined Services v HMRC [2010] UKFTT 158 (TC) 16.2.3; 17.2.1
Barking Brickwork Contractors Ltd v HMRC [2015] UKFTT 260 (TC) 16.3, 17.3.2, 17.3.4
Barletta (t/a Confurdec) v HMRC [2014] UKFTT 382 (TC) 16.3
Barnes (HMRC) v Hilton Main Construction [2005] EWHC 1355 ....16.2.2; 17.2.3
Barrett v HMRC [2015] UKFTT 329 (TC) 16.3, 17.3.4
Base Brickwork (a firm) v HMRC [2012] UKFTT 536 (TC) 16.2.3; 17.2.1
Beard v HMRC [2009] UKFTT 284 (TC) 16.2.3; 17.2.1
Begbie (t/a Ready Steady Labourers) v HMRC [2011] UKFTT 184 (TC) 16.2.3
Bells Mills Developments Ltd v HMRC [2009] UKFTT 390 (TC) 16.3; 17.3.4
Bolger v HMRC [2017] UKFTT 627 (TC) 16.3
Bosher v HMRC [2012] UKFTT 631 (TC) 16.3; 17.3.3
Britannic Estates v HMRC [2014] UKFTT 974 (TC) 14.5; 16.4.14
Bruce (t/a Norrie Bruce Plant Hire) v HMRC [2011] UKFTT 241 (TC) 16.2.3; 17.2.1
Bruns (t/a TK Fabrications) v HMRC [2010] UKFTT 58 (TC) 16.2.3; 17.2.4
Buckingham v HMRC [2010] UKFTT 593 (TC) 14.5; 16.4.1
Cardiff Lift Company v HMRC [2011] UKFTT 628 (TC) 16.2.3
Castledale Building Services v HMRC [2011] UKFTT 301 (TC) 16.3
Caunter v HMRC [2017] UKFTT 335 (TC) 16.3
Champion Scaffolding Ltd v HMRC [2011] UKFTT 375 (TC) 16.3
CJS Eastern Ltd v HMRC [2015] UKFTT 213 (TC) 16.3, 17.3.4
Connaught Contracts (Bennett) v HMRC [2010] UKFTT 545 (TC) 16.2.3; 17.2.1

Contour Business Interiors v HMRC [2011] UKFTT 300 (TC) 16.3; 17.3.4
Cormack (HMRC) v CBL Cable Contractors Ltd [2005] EWHC 1294 ..... 16.2.2; 17.2.2; 17.2.4, 17.2.5
Cormack Construction Ltd v HMRC [2010] UKFTT 380 (TC) 16.2.3
Croftport v HMRC [2011] UKFTT 419 (TC) 14.5; 16.4.4
Crooks v HMRC [2011] UKFTT 246 (TC) 16.3
Crossman v HMRC [2016] UKFTT4 (TC) 16.3
Cunningham (t/a Cunningham Construction) v HMRC [2014] UKFTT 566 (TC) 16.3
Dale Services Contracts Ltd v HMRC [2012] UKFTT 299 (TC) 16.2.3; 17.2.2
Daniel v HMRC [2013] UKFTT 136 (TC) 16.2.3
Davies v HMRC [2011] UKFTT 303 (TC) 16.3
Daw Building & Plumbing Services v HMRC [2014] UKFTT 739 ..... 16.3
Devine v HMRC [2011] UKFTT 404 (TC) 16.4.3
Devon & Cornwall Surfacing Ltd v HMRC [2010] UKFTT 199 (TC) 16.2.3; 17.2.2
Donnithorne v HMRC [2016] UKFTT 241 (TC) 14.5, 16.4.17
Dobbs v HMRC [2017] UKFTT 163 (TC) 16.3, 17.3.6
Doocey North East v HMRC [2014] UKFTT 863 (TC) 10.7; 16.4.13
Ductaire Fabrication Ltd v HMRC [2009] UKFTT 350 (TC) 16.2.3
Duffy v HMRC [2011] UKFTT 405 (TC) 16.2.3; 17.2.1
Dunn v HMRC [2012] UKFTT 550 (TC) 16.3
East Midlands Contracting Ltd v HMRC [2013] UKFTT 25 (TC) 16.2.3
East Midlands Contracting Ltd v HMRC [2017] UKFTT 25 (TC) 16.4.11
Elswood Mechanical Services v HMRC [2014] UKFTT 786 (TC) 16.3
Enderbey Properties Ltd v HMRC [2010] UKFTT 85 (TC) 16.2.3; 17.2.1
Expert Recruitment v HMRC [2014] UKFTT 738 (TC) 16.3
Farrow v HMRC [2015] UKFTT 28 (TC) 16.3
First in Service Ltd v HMRC [2012] UKFTT 250 (TC) 16.3; 17.3.4
Flack (AJ) Ltd v HMRC [2011] UKFTT 279 (TC) 16.3
Flemming & Son Construction (West Midlands) Ltd v HMRC [2012] UKFTT 205 (TC) 10.7; 16.4.5
Forsyth v HMRC [2012] UKFTT 209 (TC) 16.2.3; 17.2.1
French Polish Ltd v HMRC [2014] UKFTT 91 (TC) 16.4.11, 17.4
GC Ware Electrics v HMRC [2010] UKFTT 197 (TC) 16.2.3; 17.2.1
Getty v HMRC [2010] UKFTT 251 (TC) 16.2.3; 17.2.2
GH Preston Partnership v HMRC [2016] UKFTT 296 (TC) 16.4.11, 17.4
Gibson v HMRC [2011] UKFTT 113 (TC) 16.3

Gjoci v HMRC [2016] UKFTT 576 (TC) 16.4.3
Glen Contract Services Ltd v HMRC [2010] UKFTT 391 (TC) 16.2.3; 17.2.1
Gott v HMRC [2015] UKFTT 289 (TC) 16.3
Graffiti Busters Ltd v HMRC [2014] UKFTT 61 (TC) 16.4.11, 17.4
Grosvenor v HMRC [2009] UKFTT 283 (TC) 16.2.3; 17.2.4
Hall v Lorimer (1993) 66 TC 349 ..... 13.4; 20.5
Harris (MR) Groundworks (a partnership) v HMRC [2010] UKFTT 358 (TC) 16.2.3; 17.2.2
Heronslea Ltd v HMRC [2011] UKFTT 102 (TC) 16.3; 17.3.4
Hills Painting & Decorating Ltd v HMRC [2017] UKFTT 249 (TC) 16.3
HMRC v Bosher [2013] UKFTT 579 (TC) 16.3
HMRC v Facilities and Maintenance Engineering Ltd (FAME) [2006] EWHC 689 ..... 16.2.2; 17.2.4
HMRC v JP Whitter (Waterwell Engineers) Ltd [2015] UKUT 392 (TCC) 16.2.3, 16.2.5
Hoskins v HMRC [2012] UKFTT 284 (TC) 16.4.6
Hudson (HMRC) v JDC Services Ltd [2004] EWHC 602 ..... 16.2.2; 17.2.4
Iles (t/a Purbeck Plumbing Heating & Drainage) v HMRC [2012] UKFTT 389 (TC) 16.3; 17.3.4
Industrial Contract Services Ltd v HMRC [2011] UKFTT 290 (TC) 16.2.3
Ireton v HMRC [2011] UKFTT 639 (TC) 16.3
Island Contract Management (UK) Ltd v HMRC [2013] UKFTT 207 (TC) 3.11; 16.4.9
Island Contract Management (UK) Ltd v HMRC [2015] UKUT 472 (TCC) 3.11, 16.4.9
Ithell v HMRC [2011] UKFTT 155 (TC) 16.2.3; 17.2.6
J&M Interiors (Scotland) Ltd v HMRC [2014] UKFTT 183 (TC) 14.5; 16.4.12
John Kerr Roofing Contractors v HMRC [2013] UKFTT 135 (TC) 17.2.4, 17.2.5
Joseph-Lester (t/a Scaffold Access Services) v HMRC [2011] UKFTT 114 (TC) 16.2.3; 17.2.1
JP Whitter (Waterwell Engineers) Ltd v HMRC [2012] UKFTT 278 (TC) 15.3; 16.2.3; 17.2.4, 17.2.5
JP Whitter (Waterwell Engineers) Ltd v HMRC [2016] EWCA Civ 1160 ..... 16.2.1, 16.2.3, 17.2.5
K1 Construction Ltd v HMRC [2010] UKFTT 347 (TC) 16.2.3
KD Ductworks Installations v HMRC [2011] UKFTT 76 (TC) 16.3; 17.3.3
Kerr (John) Roofing Contractors v HMRC [2013] UKFTT 135 (TC) 16.2.3; 17.2.4

Kincaid (t/a AK Construction) v HMRC [2011] UKFTT 225 (TC) 16.2.3; 17.2.1
Koleychuk v HMRC [2012] UKFTT 224 (TC) 16.3; 17.3.6
Laithwaite v HMRC [2014] UKFTT 759 (TC) 16.3; 17.3.4
LC Property Management Ltd v HMRC [2017] UKFTT 511 (TC) 16.3
Lewis v HMRC [2010] UKFTT 327 (TC) 16.3; 17.3.3
Lewis (t/a MAL Scaffolding) v HMRC (2006) SpC 527 ..... 13.5
Lilystone Homes Ltd v HMRC [2011] UKFTT 185 (TC) 16.3
Longworth (A) & Sons Ltd v HMRC [2009] UKFTT 286 (TC) 16.2.3
M&J Plumbing v HMRC [2011] UKFTT 337 (TC) 16.3
Mabe v HMRC [2016] UKFTT 340 (TC) 14.5, 16.4.13
McDermott v HMRC [2011] UKFTT 477 (TC) 16.2.3
McDowall v HMRC [2011] UKFTT 28 (TC) 16.2.3; 17.2.1
McEwen v HMRC [2015] UKFTT 528 (TC) 16.4.16
McGillen Building Services v HMRC [2011] UKFTT 486 (TC) 16.3
Mahal Construction Ltd v HMRC [2014] UKFTT 530 (TC) 16.3
Masters At Carpentry Ltd v HMRC [2012] UKFTT 510 (TC) 16.3
Maypine Construction Ltd v HMRC [2017] UKFTT 833 (TC) 10.7, 16.4.5
MCM2 Cladding Systems Ltd v HMRC [2015] UKFTT 254 (TC) 16.3, 17.3.4
MEM Industrial Roofing Ltd v HMRC [2011] UKFTT 604 (TC) 16.3; 17.3.4
Merrin v HMRC [2015] UKFTT 240 (TC) 16.3
Midlands Electrical Contractors Ltd v HMRC [2014] UKFTT 567 (TC) 16.3
MPH Joinery Ltd v HMRC [2015] UKFTT 106 (TC) 16.4.11, 17.4
Munns v HMRC [2009] UKFTT 290 (TC) 16.2.3; 17.2.1
Mutch v HMRC [2009] UKFTT 288 (TC) 16.2.3; 17.2.1
North v HMRC [2015] UKFTT 56 (TC) 16.3; 17.3.6
Oddy (t/a CMO Bird Proofing Specialists) v HMRC [2014] UKFTT 673 (TC) 16.3; 17.3.4
O'Kane v HMRC [2013] UKFTT 307 (TC) 16.4.10
Okoro v HMRC [2015] UKFTT 269 (TC) 16.3
Parkinson v HMRC [2015] UKFTT 342 (TC) 16.3, 17.3.6
Paul Raymond Marsh v HMRC [2007] UKVAT V20091 ..... 16.4.11, 17.4
PDF Electrical v HMRC [2012] UKFTT 708 (TC) 14.5; 16.4.7
PG Glazing Ltd v HMRC [2011] UKFTT 562 (TC) 16.3; 17.3.4
Piers Consulting v HMRC [2011] UKFTT 613 (TC) 16.2.3
PM Reinforcements Ltd v HMRC [2017] UKFTT 434 (TC) 16.3, 17.3.5
Pollard v HMRC [2010] UKFTT 269 (TC) 16.2.3; 17.2.2; 17.3.6
Project Developments (South Wales) Ltd v HMRC [2012] UKFTT 322 (TC) 16.3; 17.3.5
PSR Control Systems Ltd v HMRC [2012] UKFTT 478 (TC) 16.2.3; 17.2.1

PVC Fascia Company v HMRC [2011] UKFTT 17 (TC) 14.5; 16.4.2
Quality Asbestos Services Ltd [2015] UKFTT 595 (TC) 16.4.11, 17.4
Refit Shopping Services v HMRC [2012] UKFTT 42 (TC) 10.7; 16.4.8
Regan v HMRC [2012] UKFTT 21 (TC) 16.3
Rowland v HMRC (2006) SpC 548 ..... 17.1; 17.2.1
S Morris Groundwork Ltd v HMRC [2010] UKFTT 585 (TC) 16.2.3; 17.2.4, 17.2.5
Savage (Savage Electrics Ltd) v HMRC [2014] UKFTT 521 (TC) 16.3; 17.3.4
Schotten and Hansen (UK) Ltd v HMRC [2017] UKFTT 191 (TC) 5.5, 16.4.9
Scofield v HMRC [2010] UKFTT 377 (TC); [2011] UKFTT 199 (TC) 16.2.3; 17.2.4, 17.2.5; 17.2.6
Scott Building Contracts Ltd v HMRC [2017] UKFTT 630 (TC) 16.3, 17.3.6
Scotts Glass & Glazing Services v HMRC [2011] UKFTT 508 (TC) 2.4.6; 16.3; 17.3.5; 18.4
Shaw (HMRC) v Vicky Construction Ltd [2002] EWHC 2659 ..... 15.3; 16.2.2; 17.2.4
Shaw Cleaning Services v HMRC [2011] UKFTT 378 (TC) 16.2.3; 17.2.4
SKG (London) Ltd v HMRC [2009] UKFTT 341; [2010] UKFTT 89 (TC) 16.3
SOS Joinery Ltd v HMRC [2016] UKFTT 535 (TC) 16.4.11, 17.4
Sowinski v HMRC [2015] UKFTT 636 (TC) 16.3, 17.3.4
Steve Jordan Fencing v HMRC [2010] UKFTT 570 (TC) 16.2.3; 17.2.2
Steyne Farm Co Ltd v HMRC [2014] UKFTT 787 (TC) 16.3
Stone v HMRC [2010] UKFTT 414 (TC) 16.3; 17.3.6
Strongwork Construction v HMRC [2009] 292 (TC) 16.2.3; 17.2.1
Stubbs v HMRC (2007) SpC 638 ..... 16.3; 17.3.3
Tayfield Homes v HMRC [2016] UKFTT 112 (TC) 14.5, 16.4.2
Templeton (HMRC) v Transform Shop Office & Bar Fitters Ltd [2005] EWHC 1558 .....16.2.2; 17.2.1
Terrace Hill (Berkeley) Ltd v HMRC [2015] UKFTT 75 (TC) ..4.3.3, 16.4.15
Thames Valley Renovations v HMRC [2011] UKFTT 69 (TC) 16.2.3
Thomas Dalziel Steelfixing & Formwork v HMRC [2014] UKFTT 725 (TC) 16.3; 17.3.3
Thompson Heating (2000) Ltd v HMRC [2016] UKFTT 165 (TC) 16.4.13, 17.3.4
Tony Bacon Decorators v HMRC [2011] UKFTT 497 (TC) 16.3
Turner v HMRC [2014] UKFTT 1124 (TC) 16.3; 17.3.3
UPR Services Ltd v HMRC [2015] UKFTT 415 (TC) 16.4.11, 17.4
Viridian Energy Solutions Ltd v HMRC [2014] UKFTT 785 (TC) 16.3

Westwood Houses Ltd v HMRC [2012] UKFTT 166 (TC) 16.3; 17.3.3; 17.3.5
Westworth (RW) Ltd v HMRC [2010] UKFTT 477 (TC) 16.2.3; 17.2.2
Whitten v HMRC [2015] UKFTT 490 (TC) 16.3
Williams v HMRC [2010] UKFTT 508 (TC) 16.2.3; 17.2.1
Wood (t/a Propave) v HMRC [2011] UKFTT 136 (TC) 16.2.3; 17.2.1
Woodbine Electrical Ltd v HMRC [2014] UKFTT 789 (TC) 16.3
Woods v HMRC [2014] UKFTT 569 (TC) 16.3
Woods (HMRC) v Lightpower Ltd [2005] ER 234 ..... 16.2.2
Wright v HMRC [2011] UKFTT 824 (TC) 16.2.3

General index

Accountant
reliance on 14.5, 16.4.13, 17.3.4
Agents authorisation
code 6.3
correct procedure 6.2
Customer Level Agents (CLA) 6.2
form 64-8 problems 6.1
online submissions form FB12 ..... 6.2
representation 6.3
Scheme Specific Agents (SSA) 6.2
Air conditioning installations and systems 3.7
Angola
withholding tax 19.7
Annual return
Construction Industry Scheme 1975-1999 annual return (CIS36) 1.4
Appeals
failure to deduct tax 14.3
loss of gross payment status 8.5
penalties 9.5
Architects 3.4
Artistic works 3.6; 4.3.7
Australia
CIS system 19.3; 20.5
Bank accounts
checking 7.2.1
Bathrooms 3.9
Bedrooms 3.9
Belgium
CIS system 19.7
Black market economy 1.4
Blinds and curtains 3.9; 4.3.7
Bollards 3.9
Business test
gross payment status 7.2.1
need for 1.5.3
Buy-to-let landlords 1.4; 4.3.2
Canada
CIS system 19.2; 20.5
Carpets 3.3; 3.9; 4.3.7

Cash flow
VAT offset 16.4.11
CCTV 3.9
Ceiling masonry 3.9
Certificates
classes of 1.5.6
CIS 1975-1999 certificate SC60 ..... 1.4
CIS 1999-2007 ..... 1.5.2
gross payment status CIS6 ..... 1.5.2; 1.5.6
publicly quoted companies/companies with turnover of more than £5 million CIS5 ..... 1.5.6
smaller companies CIS5 ..... 1.5.6
Cessation of trade
repayment of tax deducted 11.7
Chair lifts 3.7
Change in business ownership
gross payment status 7.6
Change of business concern 5.4
Channel Islands 3.11
Charities 4.3.5
Cleaning 3.8
Companies
compliance tests, corporation tax payments and submissions 7.2.3
limited companies, redemption of deductions – see Redemption of deductions
registration forms CIS305 ..... 2.1.2
sole trader incorporating 5.4
turnover test threshold 1.5.4
Complexity of CIS
factor re penalties 17.3.2
Compliance tests
corporation tax payments and submissions 7.2.3
failures 7.2.3
identification 7.2.4
need for 1.5.5
PAYE and NI payments and submissions 7.2.3
registration process 7.3
requirements 7.2.3
self-assessment payments and submissions 7.2.3
time to pay arrangements 7.2.3
twelve month qualifying period 7.2.3
Computer networks 3.9; 4.3.7
Concert venues
integrated sound systems 3.7

Construction Industry Review Advisory (Implementation) Panel (CIRIP) 1.6
Construction Industry Scheme 1975-1999
activities covered by scheme 1.4
ancillary services 1.4
annual return (CIS36) 1.4
black economy 1.4
businesses, application to 1.4
certificate SC60 ..... 1.4
classes of subcontractors 1.4
development corporations, application to 1.4
exemption certificate (714) 1.4
flat rate deduction at source (SC60) 1.4
framework 1.4
gross payment status 1.4
housing associations, application to 1.4
identification of contractors and subcontractors 1.4
local authorities, application to 1.4
non-industry businesses annual expenditure limit 1.4
outline 1.4
private individuals annual expenditure limit 1.4
regulation of payments between contractors and subcontractors 1.4
voucher (715) 1.4
Construction Industry Scheme 1999-2007
business test 1.5.3
certificates 1.5.2
classes of certificates 1.5.6
compliance test 1.5.5
cost to industry 15.2
gross payment status 1.5.8
impact of scheme 15.1
KPMG report 15.1; 15.2
legal framework 1.5.1
need for change 1.6
outline 1.5.1
problems with scheme 1.5.8
reform of scheme 1.6
registration card CIS4 ..... 1.5.1
turnover test 1.5.4
vouchers 1.5.7
Construction Industry Scheme April 2007 onwards
administrative burden 15.2
annual yield 1.7
cost of scheme ..... 15.2; 20.4; App. 1

future of the scheme 20.1
. alternatives 20.5
. cost of scheme administration ..... 20.4; App. 1
. justification 20.3
. past and present 20.2
. responsibilities of HMRC 20.6
. statistics 20.3
improving operation of the scheme, 2014 consultation and outcome 18.1; 18.2
. gross payment status 18.3.3
. impact of consultation 18.4
. penalties 18.3.4
. returns 18.3.1
. verification 18.3.2
overseas subcontractors 5.5
overview 1.7
payments – see Payments
penalty regime – see Penalties
registration – see Registration
Regulatory Impact Assessment 15.2
returns – see Returns
reverse premiums 3.12
set-up costs 15.2
statistics to April 2008 ..... 1.7
tax deductions – see Deductions
Construction Industry Scheme Operational Forum (CISOF) 15.3
Construction Industry Training Board levy (CITB)
deduction for 2.3.1; 2.3.2
Construction operations
artistic works 3.6
cleaning 3.8
contentious or unclear areas 3.9
end client/end beneficiary 3.5
exclusions 3.9
HMRC guidance 3.2
inclusions 3.9
installation and systems 3.7
invoice splitting 3.3
legislation 3.2
main focus 3.2
overriding principles 3.2
overseas territories 3.10
professional activities 3.4

Contractors
deemed – see Deemed contractors
definition 4.1
mainstream – see Mainstream contractors
Corporation tax
offset of CIS repayments against 12.10, 17.4
Costs of scheme ..... 15.2; 20.4; App. 1
Cupboards 3.9
Curtains and blinds 3.9; 4.3.7
Death
continuation of business 5.4
Decorative works 3.6
Deduction statements
format of 2.3.2
HMRC failures 15.6
missing statements 11.3.2
. estimating deductions, problems with 11.3.3
. guessing deduction figure 11.3.4
. limited companies 12.7; 12.9
. obtaining information from HMRC directly 11.3.4
. options available 11.3.4
redemption of deductions 11.3.1
remittance advice example 2.3.2
requirements 2.6.1
rules for 2.6.2
Deductions
failure to deduct tax 14.1
. contractor's options 14.4
. recovery of amounts by HMRC 14.2; 14.3
. test cases 14.5; 16.4.2; 16.4.6; 16.4.7
rate of 2.3.1; 5.3.2
. higher rate 5.3.3
redemption – see Redemption of deductions
timing of 16.4.10
Deemed contractors
businesses 4.3.4
charities 4.3.5
definition 4.3.1
groups of contractors 4.3.6
local authorities 4.3.5
NHS trusts 4.3.5
non-construction businesses 4.3.4
occasional subcontractors 4.3.7
£1 million threshold 4.3.3; 4.3.4

private individuals 4.3.2
property investors 4.3.3
public offices 4.3.5
schools under local authority control 4.3.4
Definitions
contractor 4.1
. deemed 4.3.1
. mainstream 4.2.1
materials 10.3
subcontractor 4.1
Development corporations
application of scheme to 1.4
Digging
payments for 3.4
Domestic work 4.3.2
Downtime on projects 13.1
Drainage installations and systems 3.7
Employment Status Indicator (ESI)
before verification 5.3.1
overview 13.3
testing 13.4
Ecuador
withholding tax 19.7
Enquiry
condition for withholding repayment 11.8
Escalators 3.7
Exhibition stands 3.9
Factoring of debts
subcontractor, by 2.3.3
Fencing 3.9
Film sets 3.9
Fire alarms and protection systems 3.9
Fixed seating 3.9; 4.3.7
Floor coverings 3.3; 3.9; 4.3.7
Foreign companies 4.2.1
Forms
agents
. form 64-8 problems 6.1
. online submissions form FB12 ..... 6.2
registration
. companies CIS305 ..... 2.1.2
. partnerships and trusts CIS304 ..... 2.1.2
. sole traders paid gross CIS302 ..... 2.1.2
. sole traders paid net of tax CIS301 ..... 2.1.2

repayment
. cessation of trade CIS40 ..... 11.7
Furniture 3.9
Gambia
withholding tax 19.7
Gang leaders/gangmasters 4.2.1
Gates 3.6; 3.9
Germany
CIS system 19.4
Gibraltar
CIS system 19.5
Gilding 3.9
Golf courses 3.9
Gross payment status
assumed holders 7.5
change in ownership 7.6
Construction Industry Scheme 1975-1999 ..... 1.4
Construction Industry Scheme 1999-2007 ..... 1.5.2; 1.5.8
loss of
. application for re-registration 8.4.3
. cash flow problems 17.2.1
. checking records and establishing facts 8.2
. effect on the business 17.2.4, 17.2.5
. guidance for HMRC inspectors 8.4.1
. human errors 8.4.1
. illness 8.4.1
. impact of scheme 15.3
. inspector's decision 8.4.3
. inspector's view 8.4.2
. internal review, request for 8.4.4
. letter of potential revocation from HMRC 8.1
. proportionality 17.2.3
. reasonable excuse 8.4
. reliance on others 17.2.2
. response to HMRC 8.3
. technicalities 17.2.6
. test cases, how to use the decisions 17.2.1-17.2.6
. time to pay arrangements 8.3
. Tribunal hearings 8.5
materials 10.2
post-April 2016 ..... 18.3.3
process of registration 7.3
qualifying for
. business test 7.2.1

. compliance tests 7.2.3
. identification 7.2.4
. turnover test 7.2.2
registration form 2.1.2
retention
. annual reviews 7.4.2
. compliance with procedures 7.4.3
. deduction statements, compliance with 7.4.4
. extent of review 7.4.4
. statistics 7.4.1
. time to pay arrangements 7.4.3
test cases 16.2.1
. loss of gross payment status 17.2.1-17.2.6
. post-April 2007 ..... 16.2.3
. pre-April 2007 ..... 16.2.2
withdrawal 7.4.4
Groups of companies
deemed contractors 4.3.6
verification 5.3.2
Health and safety 20.2
Heating installations and systems 3.7; 4.3.7
History of scheme
Construction Industry Scheme 1975-1999 ..... 1.4
Construction Industry Scheme 1999-2007 ..... 1.5
industrial action 1.2
introduction of certification and flat rate deduction at source 1.3
lump labour 1.2
motivation of the Revenue 1.2
reasons for scheme 1.1
underlying logic 1.2
HMRC
agents 6.1-6.3
bank account details, checking 7.2.1
construction operations guidance 3.2
deduction statements
. failures to respond 15.6
. missing 11.3.2; 11.3.4
Employment Status Indicator 13.3
gross payment status
. annual reviews 7.4.2
. potential revocation 8.1; 8.4.1-8.4.4; 8.5
improving operation of the scheme, 2014 consultation and outcome 18.1; 18.2
. gross payment status 18.3.3

. impact of consultation 18.4
. penalties 18.3.4
. returns 18.3.1
. verification 18.3.2
payments to
. cheques/cash 2.5.1
. due dates 2.5.1
. interaction with PAYE real time information 2.5.2
. online 2.5.1
penalties
. appeals 9.5
. categorisation 9.7
. concessions 9.4
. current regime 9.3
. mitigation 9.6
policy statement ..... App. 2
recovery of tax 14.2; 14.3
redemption of deductions
. offsetting repayments 11.6
. unredeemed deductions 15.7
registration guidance 2.1.3
responsibilities 20.6
verification system 5.3.2
Homeowners 4.3.2
Housing associations
application of scheme to 1.4
Human rights
penalties 16.2.2, 16.2.3, 16.3, 16.4.10, 17.2.5
Impact of scheme
Construction Industry Scheme Operational Forum (CISOF) 15.3
consultancy paper 2014 ..... 15.8
cost to industry of scheme 15.2
deduction statements, HMRC failures 15.6
independent survey of scheme 15.5
Ipsos MORI survey 15.5; 15.6
KPMG report 15.1; 15.2
loss of gross payment status 15.3
penalty regime 15.4
pre-1999 ..... 15.1
Regulatory Impact Assessment 15.2
set-up costs of new scheme 15.2
useful statistics 15.5
Income Tax (Subcontractors in the Construction Industry) Regulations 1975 ..... 1.4

Indonesia
withholding tax 19.7
Industrial plant
built onto land 3.9
Insolvent contractors
redemption of deductions 11.4
Interest on unpaid tax 9.3; 14.4
Isle of Man 3.11; 16.4.9
Kitchens 3.9
KPMG report 15.1; 15.2
Labour agencies 4.2.1
Legislation
Construction Industry Scheme 1975-1999 ..... 1.4
Construction Industry Scheme 1999-2007 ..... 1.5
construction operations 3.2
original scheme of certification and flat rate deduction at source 1.3
reproduction ..... App. 3
Lifts 3.7
Lighting installations and systems 3.7; 4.3.7
Limited companies – see Companies
Local authorities
application of scheme to 1.4
assumed gross payment status 7.5
deemed contractors 4.3.5
Locking systems 3.9
Machinery
installation for use in buildings 3.7
Mainstream contractors
businesses involved in utilities/telecommunications/ transport networks and infrastructure 4.2.1
business status of entity 4.2.1
construction businesses 4.2.1
example 4.2.2
foreign companies 4.2.1
gang leaders/gangmasters 4.2.1
general principles 4.2.1
labour agencies 4.2.1
property developers 4.2.1
variations 4.2.3
Malawi
withholding tax 19.7
Marquees 3.9
Materials
contractor responsibilities 10.4

deduction-exempt proportion 10.2
definition 10.3
evidence of direct cost 10.3, 10.4
exclusion from tax calculation 10.1
gross payment status 10.2
incorrect deductions 10.6
inflating the cost of 10.3
mixture of net-paid and gross-paid work 10.2
net-paid subcontractors 10.2
no recognition of 10.6
plant hire, cost of 10.5
policing 10.4
professional services 10.2
scaffolding 10.5
test cases 10.7; 16.4.8
Murals 3.9
NHS trusts 4.3.5
NI numbers
verification system 5.3.2
Nigeria
withholding tax 19.7
Non-industry businesses
annual expenditure limit 1.4
Online facilities
gross payment status (not available) 2.1.2
penalty appeals 9.5
registration 2.1.2
repayment claims 12.5
returns (monthly) 2.4.1
verification 5.3.2, 5.3.5
Ornamental fountains 3.6
Overseas operations 3.10
Overseas subcontractors 5.5
Painting 3.9
Pakistan
withholding tax 19.7
Partnerships – see also Sole traders
redemption of deductions – see Redemption of deductions
registration forms CIS304 ..... 2.1.2
sole trader becoming 5.4; 7.6
turnover test threshold 1.5.4
verification 5.3.2
Payments
establishing rate of tax deduction 2.3.1

general principles 2.3.1
gross or net 2.3.1
HMRC, to
. cheques/cash 2.5.1
. due dates 2.5.1
. interaction with PAYE real time information 2.5.2
. online 2.5.1
indirect 2.3.3
on account 2.3.1
quarterly 2.4.7
remittance advice example 2.3.2
retentions 2.3.4
unpaid tax – see Recovery of unpaid tax
verification before 2.3.1
Penalties
appeals 9.5
backdating rules 18.3.4
busyness as factor 17.3.2, 17.3.4
capping 9.3
categorisation of reasons for issue 9.7
challenging basis for imposition 17.3.5
combination of difficulties for contractor 17.3.6
complexity of CIS 17.3.2
concessions 9.4
current list of 9.3
false registration 2.1.6, 7.2.4
gross payments status 7.3; 9.1
history 9.2
human rights 16.2.2, 16.2.3, 16.3, 16.4.10, 17.2.5
interest on unpaid tax 9.3
mitigation 9.6
new penalty regime 15.4; 18.3.4
nil returns 9.4
proportionality 9.6, 16.2.2, 16.2.3, 16.3, 17.3.3
recent changes 9.4
returns 9.3
test cases 16.3; 17.3.1
. other factors 17.3.6
. proportionality 17.3.3
. reliance on others 17.3.4
. technicalities 17.3.5
Pipeline construction offshore 3.10
Pipeline inspection 3.4
Planning consultants 3.4

Plant hire
cost of 10.5
Polishing 3.9
Portable offices 3.9
Power supplies 3.7
Private individuals 1.4; 4.3.2
Professional activities 3.4
Property developers 4.2.1; 4.3.3
Property investors 4.3.3; 16.4.1
Proportionality
burden on business 15.2
defence against penalties 9.6, 16.2.2, 16.2.3, 16.3, 17.3.3
Public address systems 3.7
Public bodies
assumed gross payment status 7.5
deemed contractors 4.3.5
Racking 3.9
Recovery of unpaid tax
contractor's options 14.4
co-operation, importance of 14.5
correct identification of subcontractor 14.5
discovery/voluntary declaration 14.3
failures to deduct tax 14.1
HMRC's actions 14.2; 14.3
interest 14.4
test cases 14.5
unacceptable defences 14.5
Redemption of deductions
agents and nominees 12.5
cessation of trade 11.7
deduction statements 11.3.1
. missing statements 11.3.2-11.3.4
gross payments 11.5
incorrect deductions, repayments during tax year 11.7
insolvent contractors 11.4
limited companies
. claiming a repayment 12.5
. current system of offsets 12.2
. history 12.1
. HMRC's list of common difficulties encountered 12.8
. HMRC's recent performance with claims 12.4
. missing deductions 12.7; 12.9
. problems with HMRC's system 12.3

. reconciling differences 12.7
. repayments on account 12.6
offsets against other liabilities 11.6, 12.10, 17.4
online facility 12.5
partnerships 11.1
repayments during tax year 11.7
self-assessment and relevant periods 11.2.1
time to pay arrangements 11.6
time periods 11.2.1
unredeemed deductions 15.7
Registration
agents 6.3
all businesses 2.1.1
change in 2.1.5
gross payment status 7.3
contractor, as 2.2
forms
. companies form CIS305 ..... 2.1.2
. partnerships and trusts CIS304 ..... 2.1.2
. sole traders paid gross form CIS302 ..... 2.1.2
. sole traders paid net of tax form CIS301 ..... 2.1.2
HMRC guidance 2.1.3
multiple schemes 2.1.4
Registration card (CIS4)
minimum requirement 1.5.1
permanent (CIS4P) 1.5.1
temporary (CIS4T) 1.5.1
Regulatory Impact Assessment 15.2
Repairs and maintenance
installations and systems 3.7
Repayments – see Redemption of deductions
Republic of Ireland
CIS system 19.2
Retentions
contractor, held by 2.3.4
Returns
agents 6.3
annual CIS36 ..... 1.4
mandatory online filing 18.3.1
monthly
. activation method 2.4.2
. deadlines for submission 2.4.4; 9.3
. deemed contractors 2.4.7
. errors 2.4.7

. excluded payments 2.4.7
. exemption from submission 2.4.5
. first online return details required 2.4.3
. methods of submission 2.4.1
. nil returns 2.4.5; 9.4
. online 2.4.1
. paper returns (up to April 2016) 2.4.1; 2.4.6
. quarterly payments 2.4.7
. time of 2.4.7
penalties – see Penalties
Reverse premiums
whether within CIS 3.12
Sanitation installations and systems 3.7
Scaffolding 10.5; 13.4
Schools 4.3.4; 4.3.5
Security fencing 3.9
Security systems 3.7; 4.3.7
Self-employment
agencies 13.7
bogus workers statistics 13.6; 13.7
declarations by contractors 13.5
downtime on projects 13.1
employment status 13.2
Employment Status Indicator 13.3
. testing 13.4
Evasion Economy report 13.6
HMRC consultation document 13.6
offshore intermediaries 13.7
overview 13.1
supervision, direction and control, interpretation 13.7
temporary workers 13.1
umbrella/agency schemes 13.6; 13.7
Seychelles
withholding tax 19.7
Shelving 3.9
Shop fitting 3.9
Shot blasting 3.8
Shutters 3.9
Signs 4.3.7
Snagging 2.3.4
Soil and environmental testing 3.4
Solar panels 3.2
Sole traders
becoming partnership or incorporating 5.4; 7.6

death, continuation of business 5.4
redemption of deductions – see Redemption of deductions
registration forms
. paid gross CIS302 ..... 2.1.2
. paid net of tax CIS301 ..... 2.1.2
turnover test threshold 1.5.4
Sri Lanka
withholding tax 19.7
Stair lifts 3.7
Subcontractors
definition 4.1
Surveyors 3.4
Telephone networks 3.9; 4.3.7
Temporary structures 3.9
Temporary workers 13.1
Territorial waters
operations outside 3.10
Test cases
failure to deduct tax 14.5; 16.4.2; 16.4.6; 16.4.14
gross payment status 16.2.1
. post-April 2007 ..... 16.2.3
. pre-April 2007 ..... 16.2.2
honest mistake 16.4.7
how to use the decisions 17.1
investment properties 16.4.1
lack of knowledge 16.4.13
loss of gross payment status
. effect on the business 17.2.4, 17.2.5
. late payment due to cash flow problems 17.2.1
. proportionality 17.2.3
. reliance on others 17.2.2
. technicalities 17.2.6
materials 10.7; 16.4.4; 16.4.5; 16.4.8
miscellaneous 16.4
offset of deductions 16.4.11
overseas entities 16.4.9
penalties 16.3; 17.3.1
. other factors 17.3.6
. proportionality 17.3.3
. reliance on others 17.3.4
. technicalities 17.3.5
reconciliation of accounts and income 16.4.3
recovery of unpaid tax 14.5
subcontractor identification 16.4.12

timing of deductions and human rights 16.4.10
Theatres
integrated sound systems 3.7
Time to pay arrangements
compliance tests 7.2.3
gross payment status
. loss of 8.3
. retention 7.4.3
redemption of deductions 11.6
Trade or investment
evidence and impact 4.3.3, 16.4.15
Travel expenses
failure to adjust for 16.4.5
Tribunal hearings
failure to deduct tax 14.3
gross payment status, loss of 8.5
penalty appeals 9.5
Trusts
registration forms CIS304 ..... 2.1.2
Turnover test
£30,000 limit 1.5.4; 7.2.2
agencies 7.2.2
application rules 7.2.2
companies 1.5.4; 7.2.2
gross payment status 7.2.2
new businesses 1.5.4; 7.2.2
partnerships 1.5.4; 7.2.2
qualifying work 7.2.2
taking over businesses 7.2.2
Unique Taxpayer Reference (UTR) 2.1.2; 2.4.3
United States of America
CIS system 19.7
Value added tax
deduction statements 11.3.2; 11.3.3
offset of CIS repayments against 12.10, 16.4.11, 17.4
Varnishing 3.9
Ventilation installations and systems 3.7
Verification
before making first payment 5.3.1
change in business concern 5.4
changes in provision of service 5.3.4
failure, test cases 16.4.4; 16.45
groups of companies 5.3.2
higher rate of deduction 5.3.3

history 5.2
HMRC, contact with 5.3.2
making 5.3.2
NI numbers 5.3.2
on agreement of contract for services 2.3.1
online 5.3.2; 5.3.5, 18.3.2
partnerships 5.3.2
person who may make 5.3.2
plant hire company 10.5
requirements 5.3.2
rate of deduction 5.3.2
. higher rate 5.3.3
re-verification 2.3.4; 5.3.2
telephone service 5.3.2-5.3.4; 18.3.2
time period for 5.3.2
Vouchers
CIS5 holders CIS23 vouchers 1.5.7
CIS6 holders CIS24 vouchers 1.5.7
Construction Industry Scheme 1975-1999 voucher 715 ..... 1.4
Construction Industry Scheme 1999-2007 voucher CIS25 ..... 1.4
gross payment status 1.5.7
Water supplies 3.7
Zimbabwe
CIS system 19.7