



TAXREP 49/14 (ICAEW REPRESENTATION 120/14)

IMPROVING THE OPERATION OF THE CONSTRUCTION INDUSTRY SCHEME

ICAEW welcomes the opportunity to comment on the consultation paper *Improving the operation of the construction Industry Scheme* published by H M Revenue & Customs on 27 June 2014.

This response of 19 September 2014 has been prepared on behalf of ICAEW by the Tax Faculty.

Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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MAJOR POINTS

Introduction

1. We welcome the opportunity to comment on the proposals in HMRC's consultation document of 27 June 2014.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. We continue to participate in numerous meetings with HMRC at which the ongoing operation of the scheme and its operational difficulties are discussed.

Key point summary

4. We welcome HMRC's review of the construction industry scheme which continues to impose a very great administrative burden on the construction industry at a time when the economic demands of that industry are considerable.
5. We remain concerned that the scope of this review is too limited and some of the proposals may be too ambitious to be affordable and/or achievable.
6. We support the development of new IT services for contractors and subcontractors, but these need to be reliable and accurate. When this level of quality can be assured, the industry will choose to use online filing as opposed to paper, but this should not be mandated.
7. We support the proposal to make achieving and retaining gross payment status easier. More work is needed to ensure that where a business is in danger of losing its GPS, the decision is just and proportionate.
8. The online appeals system is good in theory, but some practical problems, particularly in relation to nil returns, remain.
9. HMRC should account for any unredeemed deductions it still retains from earlier years and be held to account if it is unable to do so.

General comments and other points to consider

10. ICAEW welcomes the intention of HMRC to question the status quo of CIS although we suggest that there are further aspects of CIS which should also be reformed. The foreword to the consultation document states the government's intention to make the tax system easier, quicker and simpler for businesses by reducing administrative burdens. CIS is specific to the construction industry, which would welcome such a reduction of its burdens.
11. We have been working with HMRC on how CIS can be made to work better while reducing the administrative burden, since plans for the revised scheme, eventually introduced in 2007, were first discussed. Problems remain and we are still very concerned that operating the scheme imposes a very large burden on the construction industry.
12. We hope that the IT developments proposed in the current consultation might make the scheme do what it was intended to do in the first place, for example, by allowing subcontractors (and their agents) to view on screen the tax that has been deducted from their payments. This would be a great improvement, but not if achieving it imposes an even greater burden of their own.
13. If this iteration of the CIS cannot make the scheme work to everyone's satisfaction then abolition should be considered very seriously as the only viable solution. HMRC already uses

well developed techniques to risk assess other industries and it may be appropriate to use these instead, so relieving the construction industry of its costly administrative burden.

14. The CIS imposes a considerable and unique burden on one particular industry. An IPSOS MORI report, "Evaluating the Construction Industry Scheme", commissioned by HMRC in October 2010, identified that the level of earnings paid using cash is now just a very small percentage of the whole. The risk of undisclosed earnings must be balanced against the cost of operating the scheme overall and it is possible that better ways to manage this may emerge in due course, as cash is used even less.

Unredeemed deductions

15. As a by-product of a recent consultation into speeding up the repayment of surplus CIS deductions to limited company subcontractors, the question arose as to how much of the total annual collection of tax through CIS (currently around £4 billion annually) was never reclaimed at all either through self-assessment for sole traders and partnerships, or PAYE for limited companies.
16. After submitting a Freedom Of Information request, it emerged that £300 – £400m each year remains unredeemed. The most likely reason for this, it was thought initially, was that some subcontractors failed to submit tax returns and that these deductions represented for the most part, the income tax and class 4 NIC that would have been due anyway.
17. However, after several months of investigation, HMRC has still not fully accounted for these large unreconciled balances. This represents almost 10% of tax collected annually through the scheme.

RESPONSES TO CONSULTATION QUESTIONS

Chapter 2: Simpler gross payment status

Q1: Will decreasing the upper limit of the turnover test enable your business to apply for gross payment status. Do you have any other comments on the turnover test.

18. We consider this will help more businesses to apply for GPS, but the formula must be kept simple with as few variations as possible.
19. We are concerned that as more sub contractors are invited to apply for GPS, there should be adequate education available to explain the statutory obligation for returns GPS brings.
20. We note that currently 90% of net paid subcontractors have turnover below £30,000. The other 10% must therefore have turnover above the limit, but these contractors have chosen not to apply for GPS for their own reasons (other factors apart).
21. Decreasing the upper limit of the turnover test would be likely to attract many more businesses, although, using the existing 90:10 proportion as a guide, not all will want to register. We suggest this may be partly because loss of GPS has serious consequences for a business. Cash flow and the relationship with clients will be adversely affected. The risk this carries is sometimes seen as too great for a small business, which will decide it is better not to have GPS in the first place rather than risk losing it.
22. For many years, ICAEW has told HMRC that the regulatory bar for obtaining and retaining GPS has been set much too high. Though the HMRC booklets have advised that a "good" record of tax compliance is required, in practice this has translated to one of almost complete perfection. We note that HMRC's own statement on this subject, citing the need for discretion to be applied in denying GPS, was withdrawn from its CIS booklets without an accompanying announcement.

- 23.** We have previously welcomed the more consistent automated review procedure introduced in 2007 when new CIS was launched, although we regret that it retains the harsh parameters.
- 24.** We welcome the recent First Tier Tribunal decisions in John Kerr Roofing Contractors [2013] TC 02564 and Terry Daniel v HMRC [2013] TC02565 in which the application of s 66, TMA 1970, requiring the exercise of discretion by an Inspector of Taxes, was critical to retention of GPS, although we note the former has been appealed. Nevertheless, we hope this has an impact on the oversight of processing GPS reviews by HMRC Inspectors.

Q2: Will simpler annual compliance tests encourage you to apply for gross payment status if you haven't already or have been refused in the past.

- 25.** This may persuade more businesses to apply, but see our comments above in relation to compliance. Fewer and simpler tests will encourage businesses to apply for GPS. We welcome the removal from the list of GPS compliance requirements of the obligation to file PAYE returns and to remit PAYE, income tax and corporation tax payments on time.
- 26.** We disagree that it should always be necessary for all ITSA and CTSA returns to be made on time. There may be occasions where this is not possible or where there has been confusion. For example, where a paper ITSA return is made after 31 October and an online return is then submitted before 31 January following. This is technically late, but it has no impact on CIS and so should not be relevant to the GPS of the business.

Q3: What are some of the other barriers to the take up of gross payment status? Is there an advantage to net status in some situations? Why do some contractors never apply for gross payment status?

- 27.** The principal reason that eligible businesses have not applied for GPS is fear of losing it. The compliance requirements allow for little margin of error and small businesses are fearful of being seen as blackmarked by HMRC should this be taken away. By comparison, the disadvantages of net payment are regarded as more controllable.
- 28.** Also, it is recognised that GPS can be an advantage in winning work, but taking on new work often requires gearing the size of business for that extra work, which means an investment. Should GPS be lost, then the business owners have to decide whether to try to sustain work at that level, or lose the investment by downsizing. In this sense, HMRC's approach to GPS could be seen as a barrier to business growth and it is questionable whether these changes will go far enough to overcome the caution of business owners.
- 29.** We note too that some businesses prefer to pay their tax as they receive income. It is not possible currently to pay tax on account of either income tax or corporation tax other than under the existing quarterly instalments scheme for large companies or the bi annual payments on account made by individuals. Net status will result in approximate amounts of tax on earnings being paid as the year progresses.
- 30.** As a by-product of this behaviour, it seems that in some cases, the business concerned never submits its year end tax returns and so these deductions suffered at source have remained unreconciled. Consequently, this retained tax is merely accumulated by HMRC. The last FOI request made, in October 2013, showed that this had amounted to nearly £1bn in the three years to 2009/10, the last year for which information was then available. We do not consider this to be an acceptable position and feel that further research into this problem is needed.

Chapter 3: CIS online

Q4: Will removing the option to make monthly CIS returns by paper present your particular business with any issues? How could HMRC help you overcome any difficulties?

- 31.** Those contractors that submit monthly returns by paper, do so out of choice or necessity. They choose whichever method best suits their needs and is administratively least cumbersome to their business. Unless the proportion choosing this method falls to a very small percentage, this option should remain. ICAEW has long been against mandatory online filing and believes the business case should drive the move to online. This has already been proved to work for income tax self assessment, where now more than 70% of taxpayers choose to file online rather than on paper, but we do not support mandation.
- 32.** The take-up of online filing of CIS returns was slow in the first year of the current scheme. As more contractors become computer-literate, the proportion who file online has risen to 80% as quoted in the consultation document. However, that still leaves around 30,000 contractors preferring to file paper returns. This may derive from force of habit, a distrust of online filing, poor broadband connectivity or because they don't want to buy software.
- 33.** To maintain this system, HMRC must ensure that these contractors receive pre-populated returns by the 5th of the month, which contractors must then send back by the 19th. There is no recourse for contractors to charge HMRC a penalty for failing to meet its obligation, although we note that contractors are fined if they miss their deadline of 19th.
- 34.** We would also note that the recent result in the long running tribunal cases where the need to file quarterly VAT returns using online methods only, has led to alternative filing methods for VAT returns being needed. The same principles could be argued for CIS returns.

Q5: Would you welcome an online appeals service?

- 35.** We are greatly concerned by the prospect of too much of this system being automated for HMRC while the burden of checking and challenging on the construction industry could be immense. Much will depend on the accuracy of the HMRC system.
- 36.** The experience of our members where automated penalties have already been introduced, such as for payroll, is that there have been a number of problems. We saw recently HMRC issuing thousands of incorrect penalty notices which employers were later told to ignore. Of course online appeals will be easier to file than those on paper, but if the quantity of appeals rises, there will be no overall benefit.
- 37.** The need to appeal incorrect penalties will impose a considerable burden on contractors. For HMRC, the process will be largely automated, but the work of checking and challenging by contractors could prove immense.
- 38.** The change to the Nil Return obligation, paras 3.18 to 3.19, seems to be an illustration of mankind serving the needs of the computer, resulting in an administrative burden.
 - If a contractor doesn't make any payments to subcontractors in a month, that person does not need to make a return.
 - There will be no statutory obligation to make a nil return.However,
 - If any contractor fails to file a return, they will be issued with an automatic penalty notice.
 - The contractor will have to appeal the automated penalty.
 - HMRC will grant the appeal because there was no requirement to file a nil return.
- 39.** So a contractor doesn't have to file a nil return, but will have to waste a lot of time if he doesn't. This does not seem to be a good system for business.

Q6: Would an integrated online account help reduce costs and reduce the burden of operating the scheme?

40. Information is always useful and is welcome if it is accurate and up to date.
41. In designing such a system, we ask that the needs of agents be considered. It is essential that agents can see what their clients can see. Where there are differences, the contractor will almost always need professional help.
42. We had understood that HMRC's legal advisers consider sharing information on CIS repayment claim differences breaches taxpayer confidentiality.
43. There is no mention of the cost of this new system, which we would anticipate being considerable.
44. We are surprised by the statement in para 3.21 of the consultation which presumes that the reconciliation problem is attributable to 'payment and deduction statements being frequently and easily mislaid'. While some statements are mislaid, undoubtedly, in the experience of our members, many statements are never issued. This does not appear to have been considered by HMRC.
45. In the responses given by subcontractors to the IPSOS MORI report mentioned in para 14 above, when subcontractors without gross payment status were asked, only 67% stated they received a statement of CIS deduction from all contractors. This means that one in three subcontractors suffers from the non-compliance of contractors who do not issue these statements. The correct tax may be deducted and paid to HMRC, but without a statement, the subcontractor may forget or prefer not to claim that tax against the actual liability. This would go some way to forming the £300 - £400M of unredeemed deductions retained annually by HMRC referred to in para 16.
46. This element of tax yield works in favour of HMRC. Since the new scheme was introduced in April 2007, no contractor has been penalised for failing to issue deduction statements.

Chapter 4: Improving the verification process

Q7: Would a search facility and/or a facility to verify more than one subcontractor at a time make the online verification service more user friendly? Is there anything else about the online service you would like to see improved?

Q8: HMRC would like to understand what impacts removing the option to verify subcontractors by telephone could have on your business. How could HMRC help you overcome any difficulties?

Q9: Would a Smartphone verification 'app' be a useful enhancement to the service and likely to be used by your business?

Q10: Would allowing extra time to verify workers be helpful if online verification was mandatory?

Q11: Do you have any views on how the existing verification process could be improved?

47. One of the main reasons that contractors use telephone verification is that the online system is not reliable. Often, the online verification process fails to recognise a subcontractor or replies that they are not registered. A telephone enquiry then results in an acknowledgement and positive response.
48. It is vital that the telephone option is retained while the online system remains so unreliable.

49. The means used to access the online system is largely irrelevant while the system itself is sub-standard. Giving extra time for verification merely allows contractors time to have more attempts at using a sub-standard system resulting in more wasted time and frustration.
50. Once the online system is working better than the telephone, businesses will naturally use it in preference, if they can. A smartphone app will then be useful for improving access, but only once the system itself has been improved.
51. The telephone verification system would be improved by removing the unnecessary preamble about online access.

Q12: Would it be feasible to remove the obligation to verify from certain categories of subcontractor?

52. No. Currently, the system is simple and all subcontractors must be verified. Trying to make this simpler will only lead to further complication.

Chapter 5: Summary of impacts

Q13: Do you have any comments on the assessment of equality and other impacts in the summary of impacts table on page 17.

53. The cost of an automated online system allowing shared access to information appears to have been included as Nil. As we have noted in our answer to Q6, we think a new system will be needed to allow access to shared information, with security protocols included and restricted access where relevant. Agent access to this information will also be needed.
54. The additional burden on contractors which we have identified in our reply to Q5, regarding appeals and nil returns, will carry a cost which needs to be quantified.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](https://www.icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx))