



## CONSTRUCTION INDUSTRY SCHEME (DRAFT FINANCE BILL 2021)

Issued 7 January 2021

ICAEW welcomes the opportunity to respond to the **Changes to tackle construction industry abuse draft Finance Bill 2021 legislation** published by HMRC on 12 November 2020.

Draft secondary legislation guidance and IT specifications need to be published as soon as possible to enable businesses to plan and software developers to make necessary changes. Indeed, as there are now only three months until the implementation date, consideration should be given to deferring commencement until April 2022. As noted in our response to the previous consultation, removing the ability to take account of the cost of materials when paying down the chain may result in there being insufficient cash to pay sub-contractors amounts that they are owed.

This response of 7 January 2021 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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## MAJOR COMMENTS

1. The off-set changes are going to take effect through Regulations. The changes are taking effect from 6 April 2021 but HMRC has not yet published draft regulations. To enable businesses to plan and software developers to make necessary changes, draft regulations need to be published imminently, along with guidance and IT specifications.
2. As there are now only three months until implementation date, we would also recommend deferring commencement until April 2022.
3. We reiterate our concerns about the proposals for materials, expressed in our response to the previous consultation ([ICAEW REP 57/20](#) at paras 29-31), reproduced below in our detailed comments. This is not a clarification of but a change in the law.
4. We urge HMRC to ensure that this legislation – and the regulations and guidance etc which as noted above have not yet been published – comply with our *Ten Tenets for a Better Tax System*, reproduced in Appendix 1, by which we benchmark the tax system and changes to it.

## SPECIFIC MATTERS OF CONCERN

### CONTRACTORS

#### Para 2: amendments to s59 FA 2004

##### Amended s59(1)(I)

5. We should welcome clarification as to how the word ‘expenditure’ is to be interpreted.
6. In particular, it is unclear when expenditure is to be considered as incurred for the purposes of this section. For example, is it when payments are due, or when payments are made, or over time as the expenditure accrues?
7. Clarification is needed here to enable businesses to know what expenditure they need to monitor.
8. We recommend that the wording is changed to make it more precise, for example to ‘total contract payments’ to be clear that it is only actual payments that are relevant.

##### Amended s59(1)(I) and s59(2)

9. Both subsections use the words ‘at any time if, in the period of one year ending with that time’. A rolling daily 12 month look-back test with immediate need for compliance from the day after the threshold is exceeded is extremely onerous for businesses to comply with, as it would require a daily running total of expenditure to be kept. This seems excessive.
10. We therefore urge HMRC to consider a less frequent review requirement (eg, 6-monthly) with a requirement to start operating the CIS after a reasonable preparation period (eg, 3 months) after the threshold is exceeded.

##### Amended s59(3)

11. The phrase ‘is not expected to make any further expenditure on construction operations’ needs clarification.
12. Deemed contractors are often large businesses and the definition of ‘construction operations’ is very wide and can include insignificant works such as minor decoration. If even such minor construction works would preclude an ‘election’ under this section because it would be unreasonable not to except such minor on-going ad-hoc works, it appears impractical.

13. We instead favour wording such as ‘...if a person is not expected to incur more than £3m in the next 12 months on construction operations...’. Alternatively, a de minimis threshold could apply.
14. The draft legislation is unclear as to how a contractor would ‘elect’ for the condition to be no longer met.
15. We consider that the election should be an explicit act by a deemed contractor.

#### **New s59(3A)**

16. We appreciate the ability for contractors to continue operating the CIS where they chose to do so. However, there will also be businesses who have not yet exceeded the thresholds and who would prefer for operational reasons to opt in to the CIS before they are obliged to do so by statute (eg, because of concerns of the length of time it may take HMRC to process a CIS registration, particularly for offshore entities). It appears this is not possible under the legislation as drafted.
17. We suggest any business should be able to elect to operate the CIS, not just those who once exceeded the threshold.
18. As above, the draft legislation is unclear as to how a contractor would ‘elect’ for the condition to be no longer met.
19. We consider that the election should be an explicit act by a deemed contractor.
20. In addition, the draft legislation seems to imply that once a contractor has elected to continue to operate the CIS after they no longer exceeded the threshold, the only way to then exit the CIS is if the business was ‘not expected to make any further expenditure on construction operations.’
21. In line with our comments regarding amended s59(3), this would appear to capture all construction operations, including very minor expenditure.
22. Again we therefore favour different wording such as ‘...if a person is not expected to incur more than £3m in the next 12 months on construction operations...’. Alternatively, a de minimis threshold could apply.

#### **Para 3(1) – Contractors – Transitional provisions**

23. We do not understand the policy rationale for the draft legislation making provision for businesses who fall within the current definition, but who would not fall under the new definition of ‘deemed contractor’, to be drawn into the new regime for CIS from 6 April 2021. It is clearly the intention to change the definition so that in future, the definition will be based on a 12-month look-back test of £3m. We would welcome clarification of why the draft legislation provides for businesses which do not fall under this definition to be kept in the CIS.
24. It also appears that for businesses in this situation, the draft legislation does not provide for an appropriate exit point. The only exit route permitted by the draft legislation is when the business ‘is not expected to make any further expenditure on construction operations’.
25. It is unclear what this means, but it would seem to include any CIS expenditure however minimal, so that only deemed contractors anticipating absolutely no relevant expenditure would be in a position to de-register.
26. The draft legislation thus leads to an absurd result. For example, a business that spent an average of £2.1m per annum on construction operations in the past but after 6 April 2021 undertakes no more construction except for minor expenditure, for example £1,000pa on decoration, would have to keep operating the scheme indefinitely. In contrast, a business that did not exceed the threshold previously but then spent £2.5m on construction operations every year would not be considered a deemed contractor.
27. We therefore strongly advocate either removing this transitional clause altogether or providing an alternative exit clause. This could, for example, allow such deemed contractors to apply the normal look-back test after an initial 12 months in the scheme (ie, from 6 April 2022).

## DEDUCTIONS FOR MATERIALS

### Para 4 amendments to s61(1) FA 2004

28. We would reiterate our concerns about the proposals for materials, expressed in our response to the previous consultation ([ICAEW REP 57/20](#) at paras 29-31 reproduced below) as this is not a clarification in the law but a change in the law.
29. *The proposals in paras 4.11-4.12 are not realistic. Consider the following example, assume a chain of contractors A to E. Contractor E buys the materials. Under the new rules, only E would be able to take account of the cost of these materials. However, in real life, E buys the materials and D reimburses E, C reimburses D and so on up the chain until the ultimate client A bears the cost by reimbursing B. If the cost of materials could not be taken into account, E would not get paid for the materials it has bought.*
30. *We hope this demonstrates that the proposed change to the rules to remove the ability to take account of the cost of materials when paying down the chain would not only reduce cash flow for contractors who do not hold gross payment status but also result in there being insufficient cash to pay sub-contractors the amounts that they are owed for materials.*
31. *We therefore recommend that this proposal is withdrawn.*
29. If the amendments are to be implemented, further clarification is needed as to how the phrase 'direct cost' is to be interpreted.

## PERIOD OF GRACE

### Para 5 new s61(4-7)

30. We welcome that the legislation allows for a period of grace to be agreed by HMRC so a business can be given some time to set up its administration of the CIS once the threshold is exceeded.
31. However, there are several issues with this provision:
  - a) Currently, taxpayers can rely on published HMRC guidance and have a reasonable expectation that the period of grace will apply to them. In future, no such reasonable expectation will apply, and it will be entirely at HMRC's discretion to grant a period of grace and how long this period will be. As such the new statutory provision is narrower than HMRC's current guidance.  
We feel that the legislation should reflect HMRC's current approach per guidance.
  - b) There appears to be no right of appeal where a notice for a period of grace is not granted by HMRC.  
We consider that a right of appeal is essential here.
  - c) The legislation appears to only allow a notice to exempt a deemed contractor from their obligations to 'deduct sums from contract payments', but not to exempt a contractor from other obligations, such as registration and reporting obligations under the CIS.  
We urge HMRC to amend the draft legislation in this respect such that a contractor is relieved of all their CIS obligations.
32. To make administration more manageable in practice and give certainty to businesses, we recommend that the legislation should instead allow an automatic period of grace, eg, of 3 months from the date the threshold is exceeded.

## RESTRICTIONS ON SET OFF – POWER TO MAKE REGULATIONS

### Para 6 new s62(3A)-(3C) FA 2004

33. Since most of the substantive changes to this process will be governed by regulations, we believe that the draft regulations under this section should be published and shared for comment as a matter of priority.

34. We also recommend that, when updating the regulations, the opportunity be taken to update Regulation 20 to allow offset against Class 1A NIC on termination payments and the apprenticeship levy.
35. There seems to be no obvious reason from a policy perspective as to why an offset against all employer liabilities, including these two elements, should not apply. We would hope that that this is an unintentional lacuna arising from the CIS legislation having not been updated to take account of recent changes.
36. Additionally, in introducing these new set-off provisions, we think it is important and appropriate that HMRC legislates the concessionary treatment in HMRC's guidance at **CISR72080** concerning repayments made between a sub-contractor and a contractor to ensure sub-contractors are always able to rely on the position, ie, a repayment of a CIS deduction that should have been suffered by a sub-contractor to a contractor should be formally recognised as a deduction under statute.
37. Without a formal legislative basis for CISR72080, there is a risk that HMRC may refuse to apply their guidance and also seek to prevent a sub-contractor from offsetting other CIS deductions suffered against their PAYE liabilities under any new set-off regime.

## PENALTIES

### Para 7 amended s72 FA2004

#### Amended s72(3) & (4)

38. The phrase 'person who exercises influence or control' requires clarification. 'Control' is an established concept in tax legislation, but 'influence' is less clear.
39. At the very least, HMRC will need to issue clear guidance on whether professional advisers would be considered as exercising 'influence' over clients in the normal course of business.

## 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 <https://goo.gl/x6UjJ5>).