

E-BOOK

Tackling the Construction Industry Scheme with Sage Accounting

A guide for small businesses



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1. What is the Construction Industry Scheme (CIS)?

The Construction Industry Scheme (CIS) is a long-running government initiative that applies to the construction industry.

What the CIS means for business

The CIS ensures the correct and prompt payment of tax and National Insurance (NI) for work done by subcontractors. It does this by making the contractor collect and pay to HMRC both tax and NI for the work undertaken by any subcontractor they use (not including materials or VAT; effectively the CIS only applies to labour).

Contractors do this by making deductions from invoices received from subcontractors, as follows:

20%

from payments for subcontractors that are registered under CIS

30%

from payments for subcontractors that are not registered under CIS

0%

for subcontractors registered under the CIS who have gross payment status



Aside from the issue of tax avoidance, cash-in-hand work gave these subcontractors an unfair advantage over others.

Why the CIS exists

The CIS means contractors effectively collect and pay tax and NI on behalf of the subcontractor.

The Government introduced the CIS to avoid cash-in-hand operations, where subcontractors avoid paying tax and NI by taking on work with no intention of declaring it to HMRC. Aside from the issue of tax avoidance, cash-in-hand work gave these subcontractors an unfair advantage over others because they could offer their services at a discount.

The subcontractor will still need to work out their tax and NI liabilities (typically yearly), just like any other individual or business, and pay the usual rate of tax and NI appropriate to their earnings too, again just like any other business.

Additionally, subcontractors need to mention any contractor CIS deductions in their tax return. HMRC will work out the tax liability, and the subcontractor will be required to pay any deficit, or will be given a tax rebate if they've overpaid due to CIS deductions. Because of the CIS, many subcontractors find themselves in a rebate position at the end of the tax year.

Registering for CIS

Contractors must register for the CIS. There are penalties for both late reporting and payment of taxes to HMRC. In addition to penalties, contractors registered for CIS but who deliberately try to evade tax payments, could end up having their ongoing tax affairs closely monitored by HMRC.

It isn't mandatory for subcontractors to register with HMRC for the CIS. However, contractors are compelled by the CIS to make a higher rate deduction (30%) from the payment of those that take on work but aren't registered. Therefore, registering makes sense, and you may find contractors expect CIS registration.

VAT reverse charge

The VAT domestic reverse charge for construction is planned to come into force on **1 March 2021**. Although not strictly part of CIS, it applies to all services and related materials covered by the CIS. It means VAT-registered CIS contractors will have to account for VAT if they use VAT-registered subcontractors, just like they might already have to account for tax and NI (irrespective of if the subcontractor is CIS registered or not). In other words, VAT-registered subcontractors will no longer have to account for VAT on work covered by the CIS and related supplies, although they will still have to complete a VAT Return and pay any VAT due from elsewhere within their work.

2. How to register for the CIS

Any contractor new to construction must register for the CIS before any work begins, although they can't register more than two months before they start paying people, but they must register before they take on their first subcontractor.

Subcontractors should register for the CIS before they undertake any work for a contractor if they want the preferential deduction rates to apply.

Do I need to register for the CIS?

Under the CIS, an individual or business is considered a mainstream contractor if they either pay subcontractors for construction work, or don't do construction work but spend an average of more than £1 million a year on construction work, in the three-year period ending with their last accounting period. The latter are known as 'deemed contractors'.

An individual or business is considered a subcontractor if they undertake construction work for a contractor. However, private households are not considered contractors for the purposes of the CIS. This means builders who only do home improvements need not register, for example. Nor are employees included within the scope of the CIS. If you're unsure if somebody is classed as an employee or not, you can use the Government's Employment Status tool.

Any type of business entity can be a contractor or subcontractor: self-employed individuals, companies, or partnerships.



There may be a need to register as both a contractor and a subcontractor if the nature of your work means you undertake both roles.

What kind of work requires CIS registration?

Most construction work outside of that commissioned by private householders falls under the CIS, including construction tasks, repairs, demolition, site preparation, alterations, and dismantling. Work for public authorities and government is included. You should consult HMRC's [CIS 340 guide](#) for more details of what's included.

However, there's no need to register as a contractor or subcontractor if you only do any of the following, which is a list based on guidance provided by HMRC, but is not exhaustive:

- Planning work, such as architecture, surveying, or landscape design
- Delivery of materials, or transport of spoil from a site (although other site preparation tasks such as demolition fall within the CIS)
- Scaffolding hire (although labour for this task falls within the CIS)
- Carpet fitting
- Construction or fabricating materials for use in construction, including plant and machinery
- Work on a site that's obviously not construction, such as running a canteen, or toilet facilities

How to register for the CIS

CIS registration isn't automatic, although once done there should be no need to renew at a later date unless you or your business' situation changes (e.g. you form a company after being a sole trader, or become VAT registered).

There may be a need to register as both a contractor and a subcontractor if the nature of your work means you undertake both roles.

Applying might involve providing details such as your trading name, and your company or Self Assessment Unique Taxpayer Reference (UTR). Individuals will need to supply their National Insurance number, and will need to know their Government Gateway ID. VAT-registered entities will need to provide their VAT number.

How you register for the CIS will vary depending on whether you're a company, or self-employed.

Registering as a contractor

HMRC provides different registration options depending on if you are self-employed individuals or companies with up to nine directors (which HMRC say comprises most construction firms) or a larger employer. Either way, the easiest way is to [register online](#). Contractors who are unable to register online can do so via the New Employer Helpline on 0300 200 3211.

Registering must be done even if your business comprises of only yourself either as a self-employed individual or as a director of a company – that is, you have no employees.

Once you've registered, HMRC will write to you with the information and guidance you need to operate as a contractor under the CIS.

If you're already registered for PAYE for your payroll and want to join the CIS as a contractor, you'll need to let HMRC know, using the CIS Helpline on 0300 200 3210. You will then be switched to the PAYE/CIS scheme.

Registering as a subcontractor

The rules about registering as a subcontractor vary depending on your type of business. The full set of registration options are listed at the [Gov.uk website](#).

Sole traders can register online via the [Government Gateway](#). Alternatively, you can phone the CIS helpline (0300 200 3210) and provide just your UTR and NI number. Registration for self-employed subcontractors is usually quick and easy, and HMRC will confirm your registration with a letter that you will receive in a week or two.

Companies that want to register as a subcontractor face a more complicated process. The company secretary should complete the form CIS – [Company Registration online form](#) (CIS305) and post it to HMRC, or phone the CIS Helpline on 0300 200 3210. To register as a subcontractor, companies must pass the following tests:

- **Compliance test:** This ensures applicants have completed and returned relevant tax returns, and paid any tax due (although some late payments are permitted as outlined in CIS305).
- **Business test:** This aims to ensure applicants are carrying out construction work or providing labour, and that the business is ran through a bank account.
- **Turnover test:** Coming in both standard and alternative versions, this is based on net construction turnover in the 12 months prior to the application. The standard test requires a net turnover of at least £30,000 for each director or beneficial shareholder. The alternative test requires a demonstration of a net turnover of at least £100,000 for the business. Notably, HMRC says this test might still be passed if turnover from non-construction work is added in.

Partnerships can [register as a subcontractor online](#) or can [complete CIS304](#) and post it to HMRC. You can also phone the CIS Helpline on 0300 200 3210. A single partner in the partnership should take the role of 'registering partner' and complete the form. That person and the partnership must already be registered for Self Assessment and have a UTR.



Applying for gross payment status as a subcontractor

As part of their application (or later if required), subcontractors can effectively opt-out of the CIS requirement that a contractor makes deductions. This means contractors will pay invoices in full. The subcontractor then accounts for their tax and NI at the end of the year, as usual, via Self Assessment for individuals and partnerships, or a Corporation Tax return for businesses.

Gross payment status can make **an important difference for cash flow** as tax is not deducted for each payment, and instead is only due when other income taxes are due. The most common reason that subcontractors want to apply for gross payment status is to **ensure they can pay any subcontractors** who are working for them.

However, not all subcontractors are able to get **gross payment status**. For example, you will have to show you've paid tax and NI on time in the past. There are also turnover thresholds as follows that you'll need to exceed (these ignore the VAT and cost of materials, and are based on the previous 12 months):



Sole traders:
£30,000 turnover



Companies:
£30,000 for each partner, or £100,000 for the whole company



Partnerships:
£30,000 for each partner, or £100,000 for the whole partnership

Gross payment status is reviewed by HMRC each year, so you will need to **maintain the above turnover thresholds**. If you fail to meet the tests for gross payment status, **you won't be able to apply** again until a year has passed.

3. CIS requirements for contractors

Following registration, the contractor does most of the administrative work when it comes to CIS. It's wise to invest in some kind of accounting software with CIS functionality to make the job significantly easier.

In summary, contractors need to do the following:

- Verify the **CIS status** for subcontractors working for them
- Calculate and possibly make a deduction on invoices received from any subcontractor, and then **pass any monies to HMRC** each month (or quarterly in some cases)
- File a **CIS return** each month with HMRC
- Ensure the subcontractor receives a **payment and deduction statement**



Using CIS-compatible software means you can verify more than 50 subcontractors at a time.

How to verify a subcontractor

Any new subcontractor you use, or any you've used before but not for two years or longer, will need to be reviewed to confirm if they are CIS registered (and hence you only need to make a lower rate deduction) or even registered for gross payments (and hence you do not need to withhold any taxes). You should do this before the work starts.

Once you've verified a subcontractor, you'll be told what rate to deduct from payments.

Unlike contractors, subcontractors are not legally obliged to register for CIS. However, if they don't then you'll have to deduct the higher rate (30%) from their payments.

Verifying up to 50 subcontractors at one time can be done using the **HMRC CIS online service**. Alternatively, you can use your CIS-compatible accounting software. Using software also means you can verify more than 50 at a time.

To verify a subcontractor, you'll need the following details from them. Because of this requirement, you may wish to issue a form to new subcontractors you work with so you have the details at hand:

- Their Unique Taxpayer Reference (UTR), which they'll find on their tax return (either Self Assessment or Corporation Tax).



For **sole traders**, you'll need their National Insurance number



For **companies**, you'll need the company name and their registration number



For **partnerships**, you'll need to know who the nominated partner is, plus the partnership's trading name and the partnership's UTR

To be able to **login to the CIS online service** you'll need your own UTR, plus the reference number for your HMRC accounts office and your HMRC employer reference.

Calculating and making a deduction

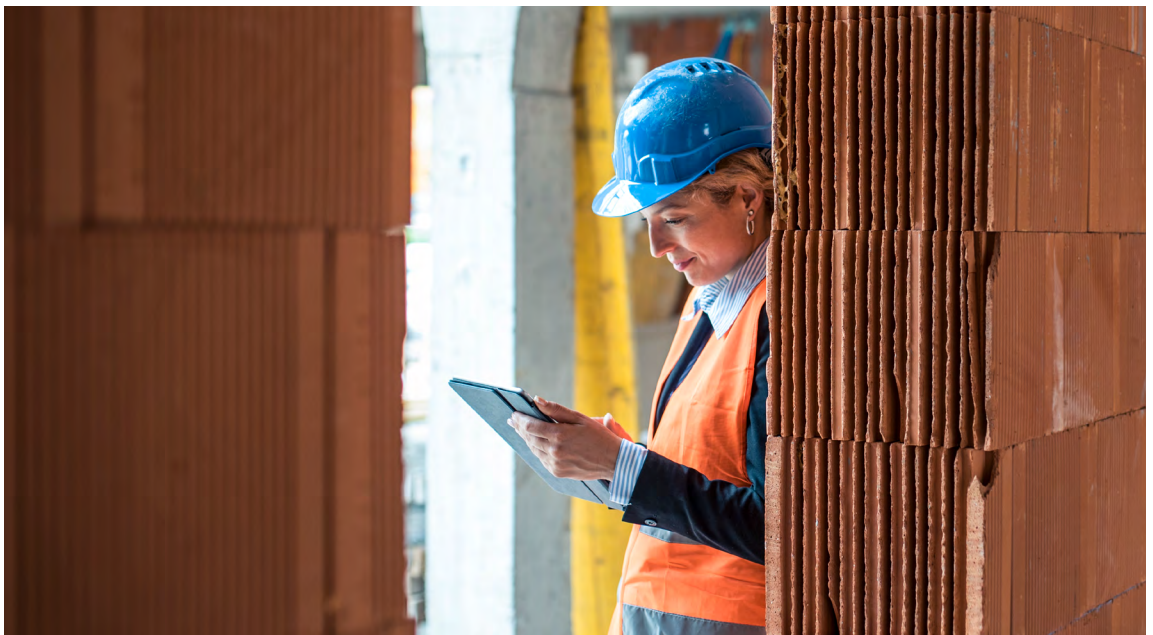
Invoices from subcontractors should be requested on at least a monthly basis for correct processing in line with your CIS requirements as a contractor. If your verification of the subcontractor showed they have gross payment status, simply pay the invoice in full.

For those without gross payment status, the steps are as follows:

1. The deduction effectively applies only to labour, so you should take the gross amount on the invoice and deduct the following, noting that this information needs to be included by the subcontractor and cannot be left off:
 - **VAT**
 - **Cost of materials** used, and any equipment that's now unusable (known as consumable stores)
This includes costs for manufacturing or prefabricating materials
 - **Fuel used** (but not that for travelling to and from the site)
 - **Plant hire costs**
2. You should then calculate the amount of the deduction based on whatever is left in Step 1. For most subcontractors registered under the CIS, you will apply a 20% deduction, while for those not registered under CIS you should apply a 30% deduction.
3. Finally, deduct the amount calculated in Step 2 from the gross invoice amount. This is what should then be paid to the subcontractor.

You shouldn't apply the deduction if the work done by the subcontractor is paid for by charities, trusts, or governing bodies/headteachers at schools on behalf of their local education authority.

Additionally, you shouldn't apply the deduction to work done by a contractor on a subcontractor's own property and costing less than £1,000 (excluding materials). But an **exemption via the CIS** helpline must be obtained first.



Contractors should keep complete and unabridged records of returns and payments for at least three years after the end of the tax year.

Paying a subcontractor

You can make the payment to a subcontractor however you wish, such as BACS transfer, issuing a cheque or even by prepaid debit or credit cards.

The CIS rules say you can pay subcontractors through a third party if you're asked to – known as paying a nominee. This might be a workmate, relative, friend, or somebody the subcontractor owes money to.

However, if the payment is for a subcontractor that has gross payment status then you can only pay the nominee the full invoice amount if they too are registered for CIS and gross payment status – and you should verify this before making any payment. If you're paying a gross payment subcontractor and the nominee does not have gross payment status, but is registered for CIS, then **standard rate deduction (20%)** should be applied. If the nominee is not registered for CIS then the **higher rate (30%) deduction** should be applied.

Paying HMRC and sending returns

Deductions you take from subcontractor invoices should be paid to HMRC on a monthly basis via your accounting software, along with returns. Alternatively, if your average monthly payments to HMRC are below £1,500, you can **choose to pay HMRC quarterly instead** (quarters end on 5 July, 5 October, 5 January and 5 April).

Payments should be made alongside and in the same way as your PAYE bill, such as via direct debit. If you don't run a payroll then you should make your CIS payments using the PAYE direct debit or bank transfer details for HMRC, as examples.

Monthly payments should be sent within 14 days of the end of the tax month they are for (a tax month starts on the 6th of one month, and ends on the 5th of the next). In other words, you should send them by the 19th following the month in which the deduction was made.

If you didn't pay any subcontractors during the month, **you must let HMRC know**, again within 14 days of the end of the tax month. If you don't, a penalty might be imposed.

The return will be created by your CIS-compatible accounting software and will contain details of all payments made to subcontractors, regardless of whether the payment was paid in full, or at the standard or higher deductions. The return should contain declarations that you considered and verified the status of all subcontractors. You will send the return by your accounting software. **Returns should be sent monthly** even if you pay HMRC only quarterly.

If, as a contractor, you simply aren't using contractors for a period of time then let HMRC know. They will then mark your CIS scheme as inactive for a six-month period. However, if you use a subcontractor again then you will obviously need to let HMRC know via the CIS helpline (0300 200 3210). Otherwise, you will need to **renew your inactive status** once the six months is up.

Contractors should keep complete and unabridged records of returns and payments for at least three years after the end of the tax year to which they related. VAT records should be kept for six years when the VAT reverse charge takes effect. Again, your accounting software should **automatically do this for you**.

Issuing a payments and deductions statement

Within 14 days following the end of the tax month you should issue to each subcontractor a statement listing each payment and deduction. The statement should identify each payment and deduction separately, but many payments and deductions may be included in a single statement.

Your CIS-compatible accounting software will automate this process and do it for you but you should get an agreement from the subcontractor if you want to send it electronically because they will need to keep it for their records, and be able to print it. You can also create the statement manually, and send it by post.

The statement should include the following at a minimum, but you can include other information, such as the VAT amounts:

- The subcontractor's name and UTR
- The gross amount of the payment (the invoice amount)
- The cost of any materials that reduced the amount against which the deduction was applied
- The amount of the deduction
- The contractor's name and employer tax reference that was received during CIS registration
- End date of the tax month for which the payment refers to (e.g. "tax month ending 5 August 2020")
- A personal verification number if the subcontractor could not be verified as being part of the CIS and the higher rate was deducted. Your accounting software will generate this when you create the payment



If the subcontractor has gross payment status then **HMRC says it's good practice** to provide the above statement for each payment, but there is no obligation to do so.



4. CIS requirements for subcontractors

Most of the administrative work required by the CIS is done by the contractor. However, the subcontractor still has requirements.

For work done for a contractor you should issue a standard invoice, including:

- **VAT**
- **Cost of materials** used, and any equipment that's now unusable (known as consumable stores). This includes costs for manufacturing or prefabricating materials
- **Fuel used** (but not that for travelling to and from the site)
- **Plant hire costs**

The invoice should list your trading name as used for CIS registration, and your UTR used during registration. If you fail to provide these details, or make a mistake, the contractor will not be able to verify you within the CIS system, and will therefore apply the higher (30%) deduction.

Because of this risk, you may wish to include a mention on the invoice that you are CIS-registered, and provide contact details for queries.

As the subcontractor, you should not make any CIS deductions on the invoice, or indicate that they should be made. That's the job of the contractor.

The contractor should send you a payment and deduction statement for the tax month the invoice was for (a tax month starts on the 6th of one month, and ends on the 5th of the next). Ensure you receive this, because it's important not only for your tax calculations, but also if you intend in future to apply for gross payment status. If the contractor goes bust without issuing the statement, you should write to HMRC to explain.

Even if they're subject to CIS deductions, subcontractors still need to file annual tax returns, such as yearly Self Assessment or Corporation Tax returns. However, there is a field on the tax return for CIS deductions and you should complete this using all the statements provided by contractors you've worked for and who have made deductions.

As the subcontractor you should not make any CIS deductions on the invoice, or indicate that they should be made. That's the job of the contractor.

5. VAT domestic reverse charge for construction

The VAT domestic reverse charge for building and construction services is an upcoming change in how VAT is handled for certain kinds of construction services in the UK, along with the building and construction materials used directly in those services (although it doesn't apply to building and construction materials supplied separately and independently of any construction services).

The VAT reverse charge for construction is effectively an extension of the CIS and applies only to transactions that are reported under the CIS and are between VAT-registered contractors and sub-contractors.

It means subcontractors will **no longer have to account for the VAT** for work done as part of the CIS. Instead, the contractor will account for the VAT (that is, it will be considered input tax for them, as if they've made the supply to themselves).

However, subcontractors still have **responsibilities around VAT**, such as identifying relevant reverse charge transactions and documenting them on the invoice.

The origins of the reverse charge for construction are similar to that of the CIS – **stamping out tax avoidance** by subcontractors who collect VAT but then disappear without paying it.



The VAT domestic reverse charge for construction begins on 1 March 2021.

HMRC says the VAT reverse charge for construction doesn't apply to subcontractors **unless** the answer to all of the following questions is positive:

- Are any of the supplies you are making within the scope of the CIS?
- Is the supply standard or reduced-rated?
- Is your customer VAT registered?
- Will your payment be reported under CIS?
- Are you sure the customer is not an end user?

If the reverse charge doesn't apply to the services a subcontractor provides then normal VAT rules apply – you should **invoice for the VAT** and account for it in your **VAT Return**.

6. How Sage Business Cloud Accounting can help with CIS

Sage Business Cloud Accounting is an award-winning accounting solution that lets you control your business finances.

It is CIS-compatible, meaning you can remove wasted time when going between different systems to check details. It means simplified accounts, and therefore means you can report confidently to HMRC when required.

CIS features within Accounting include:

- **CIS setup and management:** Enable CIS functionality as a subcontractor, contractor, or both, and setup customer and supplier details.
- **Automatic calculations:** Calculate the CIS deduction withheld on invoices and post the withheld tax correctly when processing payments.
- **Report and make e-submissions:** Report on CIS payments and withheld amounts to HMRC, generate statements, and record suffered totals as a subcontractor.
- **Invoice taking into account VAT reverse charge:** Control whether a customer or supplier is to be treated with CIS reverse charge. This is controlled both within sales and purchase invoices.





CIS compatibility within Accounting means you can:

- **Send and track accurate invoices:** Get paid on time and protect your cash flow. Set up contacts, invoice with the correct VAT, and record part payments on any device. Personalise your invoices and track whether they've been received, read and paid.
- **Forecast your cash flow:** See how much money is coming in and out of your business each month, with dashboards and bespoke reporting. Produce statements for all subcontractors, which are ready to send for easy subcontractor reconciliation.
- **Take care of tax and compliance:** See a live running total of your tax liabilities, plan ahead and submit to HMRC electronically (including CIS300) for free. Accounting keeps you on top of latest legislation with domestic reverse charge also included.

Additionally, Accounting contains other useful features to help grow your business:

- **Snap and capture receipts:** Pull in data and documents including receipts automatically with live bank feeds and AutoEntry.
- **Pay your people:** Run your next payroll securely, accurately and compliantly.
- **Share access with your accountant:** Collaborate securely in real time. Let your team spot and fix mistakes. Works on any device.



Discover more about how Sage Business Cloud Accounting can help your construction business and give you peace of mind.

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