

CIS - compliance rules, penalties & recent tax cases

(Lecture B1077 – 10.29 minutes)

Paying the tax

The contractor must pay-over any tax deducted to HMRC on a monthly basis. Payment is due by the 19th (22nd if made electronically). Contractors will typically tie this in with their other payroll obligations.

The tax can be paid quarterly where monthly payments to HMRC (including PAYE deductions) are less than £1,500 on average.

The contractor must provide a statement to the subcontractor showing the tax deducted. Statements are normally issued electronically. The statement is due 14 days after the tax month to which the invoice relates (ie, by the 19th of the following month). Penalties can be charged if a statement is not provided.

[As a word of warning, advice for contractors is not to include inflammatory words like “employment” or “payslip” on the statements issued to sub-contractors for obvious reasons...]

If HMRC discover that a contractor had an obligation to make CIS deductions but failed to do so, HMRC can make a determination under the Construction Industry Scheme Regulations 2005 on a contractor to collect them.

However the Regulations (Reg 9) state that HMRC can relieve a contractor of any liability either:

- If the failure was as a result of an “error made in good faith” or a “genuine belief” that the payment was not within the scope of the scheme; or
- The subcontractor’s income (including the payment in question) has been declared and the sub-contractor has paid the tax due in respect of this income.

Setting-off deductions

Sole traders (including partners in partnerships) will set-off any CIS deductions against their income tax and NIC liabilities under self-assessment.

Companies acting as a subcontractor may have CIS deductions taken from their income.

These deductions will first be set-off against their monthly PAYE payments. Where the company’s own CIS deductions are greater than the PAYE, the excess is set against future PAYE payments in the same tax year. If an excess still remains at the end of the tax year – which is often the case for “one-man-band” companies where the director draws dividends rather than a salary - this can be either refunded to the company or set against corporation tax.

Online returns

A monthly online return (form CIS300) is required by the 19th of the month detailing all payments made to sub-contractors in the previous month (ending on the 5th). The return must also include details of the tax deducted (if any) and any materials provided by the sub-contractor.

Contractors who choose to pay tax quarterly will still be required to submit an online return every month.

Returns do not need to be submitted where no payments have been made in the previous month although contractors are asked to notify HMRC that no return is due in order to prevent an automatic fixed penalty notice being issued. Any penalty notices issued for nil returns will be cancelled.

No annual return is due under the CIS.

Contractors have to make a declaration each month, on the return, that they have considered the employment status of each sub-contractor and they regard them as self-employed. A penalty of up to £3,000 can be charged if the wrong employment status for a sub-contractor is declared on the monthly return.

Penalties

Like many of its counterparts, the penalty regime attaching to the CIS is potentially expensive for those contractors who do not get to grips with it. For busy contractors (and their staff) who have better things to do with their time, outsourcing the CIS compliance function is therefore an attractive option.

The penalties for a late CIS return are as follows:

- £100 if the return is late;
- An additional £200 if the return is 2 months late;
- The higher of £300 or 5% of the tax due if the return is 6 months late;
- An additional £300 or 5% of the tax due if the return is 12 months late; and
- Further tax related penalties if the failure continues and information necessary for HMRC to assess the penalties is withheld.

Capping of CIS fixed penalties has applied since October 2011. Capping only applies to “new” contractors being those who until 29 October 2011 had never filed an online form CIS 300.

Capping means that the total of all the fixed CIS penalties applying during the “capping period” are subject to a maximum of £3,000. The capping period starts on the date that the contractor first had an obligation to file a CIS monthly return and ends at the 5th of the month following the date the contractor filed their first CIS 300. Capping will not therefore apply to a contractor for any periods once a CIS 300 has been filed.

Capping applies only to the fixed CIS penalties – ie, the £100 and £200 penalties. The tax geared penalties are not capped and, if applicable, will be issued in addition to the capped fixed penalties. In practice this means that while capping appears generous on the surface, in reality it is normally of limited help.

The penalties for the late payment of CIS deductions are the same as for PAYE and are based on the number of defaults in the tax year.

The first late payment in the tax year does not count as a default. Thereafter the penalty is 1% of the tax paid late for the 1st, 2nd or 3rd default rising to 2% for the 4th, 5th and 6th default, 3% for the 7th, 8th and 9th default and finally 4% for the 10th and subsequent default.

If the tax is outstanding for more than 6 months, a penalty of 5% is charged with a further 5% penalty after 12 months.

Interest is also charged on any tax paid late.

The penalty for an incorrect return is up to £3,000. As each monthly return can be eligible for a penalty, the same error repeated for a year could cost up to £36,000. However these penalties are mitigable depending on the degree of culpability and the nature of any disclosure. Errors on CIS returns can normally be corrected online (or via the CIS Helpline) and in many cases the prompt disclosure and correction of an error will avoid any penalty charge.

Contractors and their authorised agents can make an electronic appeal against CIS late-filing penalties by using HMRC's Online Penalty Appeal Service (PAS). The PAS will display the penalty details. Contractors and agents can access PAS using options in PAYE/CIS Online.

Once the appeal has been processed, a Generic Notice will be issued giving result of the appeal. This can be accessed online through the 'Generic Notices' option. Only if the appeal is rejected will it be referred to the HMRC Reviewing Officer.

Finally here are 3 (relatively) recent tax cases involving CIS compliance issues to share with you:

Barrett v HMRC (2015)

Mr. Barrett was (and probably still is for all we know) a self-employed jobbing builder. On jobs which required more than his own two hands he engaged the services of sub-contractors. He had previously worked as a sub-contractor himself for a large building contractor and had received his payments net of CIS deductions, so he had knowledge of the scheme. However he assumed (wrongly) that the CIS did not apply to small businesses like his own which mainly worked on private homes. His accountant was also blissfully unaware of this fact. Payments by Mr. Barrett to his sub-contractors were duly made gross and no CIS returns were filed and no tax deductions made.

For the 4-year period under review, the deductions which ought to have been made under CIS amounted to only £2,000. The tax at stake was not therefore a national catastrophe.

However for the period under review, nil returns were required (HMRC only agreed to not charge penalties for nil returns from April 2015). Therefore the total penalty liability for the period – bearing in mind the tax at stake was a little under £2,000 – was an eye-watering £128,000. This consisted mainly of penalties for the non-filing of monthly CIS returns plus a few penalties for the non-payment of CIS deductions.

Mr. Barrett (not surprisingly) appealed the penalties on the grounds that:

- (a) The penalties were disproportionate (this was dismissed by the FTT on the grounds that they did not have the jurisdiction to consider arguments of proportionality in the context of direct tax penalties);
- (b) HMRC should waive CIS payments of £1,800 in relation to a sub-contractor whose tax affairs had been (belatedly) brought up to date (this was also dismissed as the sub-contractor was so late in filing his own returns that the original determination to require Mr. Barrett to pay the CIS deductions could not be revisited); and finally
- (c) He had a reasonable excuse, that being his reliance on his accountant.

The case therefore rested on point c).

The Tribunal held that it was reasonable for Mr. Barrett to rely on his accountant in this case. Mr. Barrett's awareness of the CIS had arisen in a different context and did not mean that he ought therefore to have understood its wider impact.

The accountant on the other hand was a professional engaged by Mr. Barrett to deal with his accounts and his tax obligations including PAYE and related matters. The accountant was fully aware that Mr. Barrett was engaging sub-contractors. Mr. Barrett had supplied all relevant information and would have been entitled to rely on his accountant to draw his attention to any relevant filing obligations.

As the Judge said...

"It would also have been reasonable for such a taxpayer to have concluded, from his accountant's silence, that there were no such obligations outstanding."

For this reason, Mr. Barrett's appeal against the penalties was allowed.

Schotten & Hansen (UK) Ltd v HMRC (2017)

Schotten & Hansen (UK) Ltd ('S&H') is a UK company that supplies and fits high-end wooden flooring. The directors (Mr. & Mrs. Hansen) had come to the UK from Denmark in 2002.

Some of the flooring is imported from Germany and is of such a high specification that S&H – on the occasions that this flooring was ordered by a customer – engage the services of a German company to carry out the installation work. On such occasions, the German company sent a fitter from Germany to the UK and S&H paid the fitter's labour and travel expenses. The German company supplying the fitters was S&H's only sub-contractor (all other jobs were carried out by its UK employees).

HMRC carried out a CIS compliance check and discovered that S&H had not deducted 30% tax from payments made to the German sub-contractor (the German company had not registered as a subcontractor in the UK so the 30% deduction technically applied).

The tax which should have been deducted in the period under review came to £395,000. Penalty notices for the late filing of CIS returns and non-payment of tax were subsequently issued in the amount of £28,000.

S&H explained that it had taken advice on their UK tax obligations (including the CIS) from a “major international firm of accountants” which it knew and trusted (having previously used their Danish counterparts at home). S&H registered for the CIS in 2005 but no returns had been filed as no UK sub-contractors were used. S&H had no reason to believe that a German sub-contractor would fall within the CIS and this had not been pointed out to them by their accountants who were also unaware that the CIS applied to foreign sub-contractors. This was therefore a single error which was repeated year-on-year. S&H therefore had a “reasonable excuse” for failing to submit CIS returns.

The Tribunal decided that it was not unreasonable for S&H to assume that their UK accountants would properly and fully advise them of their UK compliance obligations. The taxpayers had come to the UK and had engaged the services of an accountancy firm in the UK which they trusted. It was unreasonable to expect the company to check whether tax should be deducted from payments to a foreign sub-contractor.

The Tribunal therefore concluded the taxpayer had a reasonable excuse and set aside the penalties.

This is not the first time that we have seen the Tribunal give a sympathetic hearing to taxpayers who argued that the failings of their accountant or tax adviser is a reasonable excuse when considering liability to penalties. It seems that the world is cottoning-on to the common sense viewpoint that if you pay someone to do a job and they don't do it properly, then what happens after that is not your fault.

JP Whitter (Waterwell Engineers) Ltd v HMRC (2017)

Finally here, the First Tier Tribunal case of JP Whitter (Waterwell Engineers) Ltd v HMRC (2017) which concerned HMRC's decision to withdraw gross payment status from the sub-contractor company on the basis of a number of PAYE failings in the preceding 12 months.

The company accepted that 7 of the previous 12 PAYE payments had been late and did not put forward any reasonable excuse for the late payment. However, the company argued that the withdrawal of gross payment status would inevitably lead to a loss of some (if not all) of its major contracts, and that this would in turn lead to job losses.

The company's appeal was on the grounds that in a 2011 FTT case (Scofield v HMRC), the Tribunal had said that HMRC has a power but not an obligation to remove gross payments status. Gross payment status should not therefore be removed automatically and HMRC should instead exercise its discretion before so-doing. The company argued that when exercising their discretion, HMRC was obliged to consider the wider impact of any decision to remove the company's gross payment status.

The FTT agreed that taxpayers within the CIS have various safeguards against the removal of gross payment status and that HMRC has discretionary powers to allow a taxpayer to retain that status despite minor compliance failings.

However the consideration of what the Judge called “matters extraneous to the CIS regime” was not one of the safeguards within the CIS code and HMRC's discretion should be limited to the matters set out in that code.

The CIS rules protect taxpayers from penalty sanction if the taxpayer has a reasonable excuse for non-compliance. The company had no such excuse. The CIS code makes no reference to the financial impact on a business of removing its gross payment status so this should not be a matter HMRC is obliged to consider. The appeal was denied.

This seems a little harsh as gross payments status is – if you think about it – just a question of cash flow and cash-flow is far more important to small businesses than it is the Government (the UK is already £1.8 trillion in debt so waiting a few extra months to collect JP Whitter's tax wouldn't have been life-changing). And it was not as if the appellant company here had not already been punished for its PAYE failures (interest having been charged on the PAYE paid late). Denial of gross payments status was therefore something of a double-whammy.

In reality the appellant company was probably already on a yellow-card with HMRC (more accurately on several yellow cards) having previously been given some leeway with regard to its previous misdemeanors, so its consistent inability to comply with its PAYE responsibilities seems to have pushed HMRC right to the end of its tether. One would hope that businesses in a similar position who had not incurred the wrath of HMRC to the same extent as JP Whitter Ltd might get a more sympathetic hearing.

And I've just clicked on JP Whitter's website and it seems they are alive and well and have not been driven out of business by this setback which is good to see. So if you live in East Lancashire and need a submersible pump to be installed in your borehole, give them a go. [In the interests of balance, other Lancastrian submersible borehole pump installers are available.]