ZAZEN TAX

CIS Explained

The Construction Industry Scheme from both sides, for the contractor deducting and the subcontractor being deducted from.

Eight chapters. Both sides of the same scheme.

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Contents

Chapters two to four are the contractor's. Five to seven are the subcontractor's. The rest applies to everyone.

CHAPTER ONE What the scheme is, and who is caught by it

A withholding tax on construction labour, designed for an industry that HMRC decided it could not otherwise keep track of.

If you pay subcontractors for construction work you are a contractor under the scheme. If you are paid for construction work you are a subcontractor. A great many businesses are both at the same time, deducting from the people below them and being deducted from by the people above.

The rate is 20 per cent for a registered subcontractor you have verified, 30 per cent where HMRC cannot identify them, and nil for gross payment status. It comes off the labour element of the payment and nothing else.

It is not an extra tax. It is the same tax, collected earlier and by someone else. That distinction matters because it decides where the money sits in your accounts, which is the subject of chapter six.

What counts as construction operations

- Building, altering, repairing, extending and demolishing
- Installing heating, lighting, power, water and drainage
- Site preparation, groundworks and foundations
- Painting and decorating the inside or outside
- Cleaning the inside of a building after construction

Supplied on their own, professional services such as architecture and surveying are outside it, as is manufacturing components off site and installing seating, blinds, shutters or security systems.

CHAPTER TWO Verifying, and why the order matters

Everything about verification is decided by when you do it relative to the first payment.

Before you pay a new subcontractor anything, you verify them with HMRC. You need their Unique Taxpayer Reference, and their company registration number if they are a company. HMRC tells you which rate applies and gives you a verification number.

> **IT CANNOT BE FIXED AFTERWARDS**
>
> The higher rate applies from the first payment onwards. Verify someone in August and you cannot re-rate what you paid them in June. The 10 per cent difference on those payments is money out of their pocket, caused by you, and you cannot give it back.

You can reuse an existing verification number for the same subcontractor if you have paid them in the current or previous two tax years. Longer than that and they need verifying again.

CHAPTER THREE Calculating the deduction

On the labour, and only the labour.

Take the invoice. Remove the VAT. Remove the materials, the plant the subcontractor hired in, the consumable stores, the fuel other than for travelling, and any manufacturing or prefabrication they paid for directly. Remove any CITB levy you deducted. Apply the rate to what is left.

A £4,000 invoice, £2,500 labour	Correct	If done on the total
Amount CIS is calculated on	£2,500	£4,000
Deduction at 20 per cent	£500	£800
Taken in error		£300

Do it on the VAT-inclusive total instead and the error is £460 on a single invoice. Across ten payments in a month it is easily four figures.

None of it is lost. It is credited at the year end, or against a company's PAYE month by month. But until then it is the subcontractor's working capital sitting in HMRC's account, and they are the one funding the gap.

THE CITB LEVY

Where you deduct the levy from a payment, it is excluded from the gross amount of payment on the monthly return, so it reduces the figure CIS is calculated on. HMRC's own example is a £1,000 contract with a £7 levy, reported as £993.

CHAPTER FOUR The monthly return, and the 19th

One date that does not move, and one obligation people forget entirely.

A CIS tax month runs to the 5th. The return and the payment are due by the 19th of the month that follows. Payments made on the 6th belong in the next return, which is why working to calendar months puts a handful of payments in the wrong month every year.

The return asks for three figures: total payments excluding VAT, total cost of materials, and total deducted. The materials figure is everything excluded from the deduction, not just materials narrowly defined.

You also owe a statement

Every subcontractor you deducted from is entitled to a written payment and deduction statement within 14 days of the end of the tax month. That statement is their evidence for claiming the credit. Without it they are claiming something they cannot support.

> **THE NIL RETURN**
>
> If you are registered as a contractor, a return is due for every tax month whether or not you paid anybody. A month with no subcontractors is a nil return, not no return. This is the most common CIS penalty there is: the work stopped and the returns did not. £100 the day it is late, £200 more at two months, and it is per return. Tell HMRC you are inactive and they stop for six months.

CHAPTER FIVE Being deducted from

From the other side of the same transaction.

Register with HMRC as a subcontractor before you start work. Registering is what gets you 20 per cent instead of 30, and it is free and quick. Not registering costs you a third more of your labour, held until the year end.

Split every invoice between labour and materials. A contractor who receives an invoice with one total on it either sends it back or deducts on the whole thing, and neither helps you.

Keep the statements

You can only claim what you can evidence. Chase the statement in the month, not the following January. The contractor who is slow with paperwork in June is the one who has stopped answering the phone by March.

CHAPTER SIX Claiming it back

Where the money sits until you get it, and the single most common bookkeeping mistake in the trade.

CIS suffered is tax paid on account. It is not an expense. It belongs on the balance sheet as a debtor until it is set against what you owe.

> **WHAT HAPPENS IF YOU EXPENSE IT**
>
> Two things go wrong at once. Your profit is understated by the whole amount, and then you claim the same money again as a credit against the tax bill. On one set of figures that turns a £21,600 profit into a £3,960 loss on paper, and then claims £25,560 of credit against tax on a loss.

A company sets CIS suffered against its PAYE month by month, through the employer payment summary. That is a significant cash flow advantage over a sole trader, who claims it on the self assessment return and waits.

CHAPTER SEVEN Gross payment status

Three tests, and the one everybody misreads.

Gross payment status means nothing is deducted at all. It is not a tax saving, it is a cash flow one: instead of HMRC holding 20 per cent of your labour until the year end, you hold it.

The three tests

- Business test: you run a construction business in the UK, largely through a bank account
- Turnover test: net construction turnover of £30,000, or £30,000 for each relevant person or £100,000 in total for a company or partnership
- Compliance test: everything filed and paid on time for twelve months

> **TURNOVER MEANS LABOUR**
>
> HMRC measures the turnover test on net construction turnover, which its own manual defines as gross income from construction work excluding VAT and the cost of materials. So a sole trader who invoiced £48,000 with £20,000 of materials has £28,000, and fails a £30,000 threshold by £2,000, having looked at the invoice book and assumed they were nowhere near the line.

The compliance test is the one that takes status away again. Passing once is not keeping it.

CHAPTER EIGHT Where it goes wrong

In roughly the order it costs money.

- Paying before verifying, which cannot be undone
- Deducting on the invoice total instead of the labour
- Missing nil returns in a quiet period
- Working to calendar months rather than to the 5th
- Never sending statements, so subcontractors cannot claim
- Expensing CIS suffered and claiming the credit too
- Assuming CIS registration settles employment status
- Applying for gross payment status on invoiced turnover

Where to go next

The CIS Deduction Calculator, the Gross Payment Status Checker, the Statement Log, the Monthly Return Workbook and the Verification Register cover everything in these chapters.

Every calculator and workbook mentioned in this book is free on zazentax.com, with no email form. They use the same figures and the same rates as the chapters here.

Zazen Tax

Accountants for people who build things. If you would rather someone else did this, that is what we are for.

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