

# Construction Industry Scheme

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**Guidance and Commentary**

2nd edition

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## **10. Materials**

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### **10.1 Introduction**

Within CIS, if a subcontractor provides and charges for materials as part of the service to the contractor, the intention is for that proportion of the charge not to include a profit margin and for it to be excluded from any calculation of tax to be deducted. Suppliers of materials with no labour element are excluded entirely from any CIS reporting requirements. This includes delivery to site or business premises.

### **10.2 Who does this affect?**

For subcontractors with gross payment status, this is not an issue. All that is paid to them is done so without any need for distinguishing what element is for materials, labour, expenses or profit.

For net paid labour-only subcontractors, the whole amount of any payments is subject to deduction, irrespective of any expenses incurred.

Those providing professional services, defined as architects and surveyors, are exempt from CIS in any event unless their remit extends to become that of developers. Any time spent by other subcontractors in trying to interpret exactly what is needed on site, may not be classed under this heading.

That leaves the net paid subcontractors whose services include the cost of materials and the provision of plant as well as labour. Those businesses need to show separately on their invoices (or applications), the part of the total that is subject to deduction and that which is not. But how do they arrive at that deduction-exempt proportion?

Some simply do not bother. They accept the deduction of tax on the whole payment as a savings scheme for SA tax, or offset it against PAYE/NI/CIS liabilities due. Such businesses may have a mixture of net-paid industry work and gross-paid domestic work, so deductions are less of an issue. However, given the cash flow difficulties of many businesses involved in construction, parking

this money up to be set against a payment months in advance that may not even be payable, is not a viable option.

Therefore, for that business to minimise its tax deduction legitimately, or to make the correct calculation of the proportion of a charge that is not subject to tax deduction – which is classified for CIS as materials – how should that be calculated?

### **10.3 Definition of materials**

If actual building materials are provided as part of the subcontractor's service to the contractor, then according to HMRC, the amount not subject to CIS deduction should be the actual cost of those materials to the subcontractor. But that rather naively assumes that the subcontractor provides – or has delivered to site – materials for which can be produced one or more invoices arriving at exactly the amount charged for.

That may indeed be the case if a particular shade of paint, or type of cladding or roofing material, has been specified by the end client. But for such things as plasterboard, carpet underlay or cabling, the subcontractor will buy these in large quantities, to be used in several projects. If the price of copper pipe goes up, should the subcontractor include the price of the stock held when the job was priced, or the cost when it was installed – if he can remember which was used in this particular job?

If some remnant stock from an earlier job is used, should that be charged at the unit cost per the invoice, or at nil given that the whole cost may have been recovered in that earlier job?

Hold that thought for a minute. What HMRC wish to avoid are abuses of the scheme by subcontractors, who may be tempted to inflate the cost of materials so as to reduce the tax deduction artificially. A plasterer's charge to a contractor should not include 90% for materials.

So as long as the materials element is "sensible", no consequences should arise. This has not prevented HMRC from raising some rather semantic arguments. Indeed, in CIS340 the responsibility is placed on the contractor.

It says, the contractor "can ask for evidence of the direct cost of materials" – without defining what is evidence. Without provision of

this evidence, the contractor must make a fair estimate of the actual cost of the materials.

The guidance in CIS340 does not spell out what the contractor should do with this evidence. Presumably, as with the declaration of consideration of self-employment in the monthly CIS return authorisation, the contractor should satisfy himself that all is well. But how can that be proved to an inspector?

#### **10.4 Policing of materials**

CIS340 states that if the materials element “looks excessive”, an explanation may be sought by HMRC. How can a tax inspector that has never worked in construction determine what is excessive?

If a subcontractor has taken too long for the work or has made errors that created costs for the contractor, should any deduction be made from the materials element or (more likely) the due-for-tax-deduction element? This often happens, so if the ratio shifts from 50:50 of materials/labour to 80:20 because of that reduction in authorised payment, is the HMRC inspector then going to penalise the contractor?

The best defence for the contractor in this situation would be to ask that the inspector proves that the tax and accounting treatment was reckless, and the evidence for arriving at that conclusion; also to ask how much tax was lost to Treasury as a consequence and to ask for a Regulation 9(5) finding (see **Chapter 14** for more details). Unless the materials were ludicrously overstated, it would be a brave inspector that took such a case to a Tax Tribunal.

HMRC have been quite assertive in this area recently. Contractors have been asked to evidence the deductions for materials, insofar as copies of invoices have been requested. Nowhere in CIS340 is it suggested that contractors should ask for this from their subcontractors. Whilst this might be a good idea (should this be practicable), it is just more time to be spent on compliance by the contractor. As mentioned in **Chapter 14**, this is something else in which HMRC can be asked to exercise their powers under Schedule 36 of FA 2008 – in other words, to ask the subcontractor to justify his figures but under the principle in CIS Manual 83050 that HMRC should not recover more tax than is correctly payable.

## 10.5 Other deductions to be included with materials

A subcontractor may include with materials, cost of plant hire. That is, actual costs charged by third parties for the provision of plant including fuel for its operation and presumably, though not stated, any costs for the delivery of that plant to site.

What may not be included is any charge for plant that the subcontractor owns. Therefore a net paid scaffolding firm must suffer full deduction of tax from its payments unless any poles or other equipment are hired in. HMRC make no recognition of the fact that scaffolding boards have a limited life and may not be repaired.

One complication that can be raised is when a plant hire company provides an operator with the item of plant. If the invoice simply specifies plant hire, then it can be regarded as such, not least because the hiring company is unlikely to be CIS registered and would be unhappy at having tax deducted. But what happens when the plant hire invoice indicates a labour charge as part of the overall cost? Is that merely a breakdown of the cost or is the company asking for tax to be deducted from that element of the cost? In CISR14240, there is a direct reference to plant hire with operator for use on site, as being an integral part of construction. Therefore the plant hire company needs to be verified, the whole of the cost should be processed by the contractor of that service through CIS, with the non-labour element treated as materials and the labour element subjected to tax unless the hirer has GPS.

Other than plant hire, that is it. All other costs sustained by the subcontractor must be met from the net sums received.

## 10.6 No recognition of materials

If a subcontractor invoices a contractor and shows – correctly – part of the charge as being for plant hire, the contractor may ignore this and apply the tax deduction to the whole of the payment. What should the subcontractor do?

As this pertains to an incorrect deduction, as covered in **Chapter 14**, the options are to accept the position and redeem the tax later, to ask the contractor to correct the deduction or to apply to HMRC with the details of the excessive deduction. The only difference here is that HMRC may refuse on the basis that the contractor has made

what was felt to be a necessary correction. The time and effort to argue the point may not be worth the outcome.

## 10.7 Test cases

The contractor cannot simply contend that the materials element of an invoice looks correct and then insist that such satisfaction is its own evidence. This was the principal tool used in *Flemming*, to question an HMRC assessment based on excessive statement of materials; in the absence of any other evidence, the FTT upheld the assessment.

The issue of exemptions for travel expenses was not fully explored in *Refit Shopfitting Services*; on the face of it, these should not be exempt from deduction, but HMRC granted a reg. 9 direction. Claiming such a direction, as with failure to deduct tax from labour costs, should be a defence to negotiate with HMRC before going to FTT, especially if the subcontractor will co-operate.

Lack of knowledge of CIS, leading to the acceptance of material costs stated (as plant and other expenses) can be costly – the contractor lost heavily in *Doocey* in such a situation. This emphasises the need to ensure that staff dealing with CIS understand its complexities. This can occur in small contractor firms, or much larger companies such as *Maypine*.

It would be of benefit for accountants to talk to their construction clients about their procedures for invoice authorisation, to prevent such costs occurring.

**Cases:** *Refit Shopfitting Services v HMRC* [2012] UKFTT 42 (TC); *Flemming & Son Construction (West Midlands) v HMRC* [2012] UKFTT 205 (TC); *Doocey North East v HMRC* [2014] UKFTT 863 (TC); *Maypine Construction Ltd v HMRC* [2017] UKFTT 833 (TC)

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