

4. Contractors and sub-contractors

4.1 Definitions

A contractor is a business entity that engages another business entity to undertake paid work. That other business entity is a sub-contractor.

These are the definitions for CIS. In some industries, a freelancer may term himself a contractor – that is to distinguish him from being an employee. CIS does not concern itself with employees, so the definition above will be used.

Some business entities can be both contractor and sub-contractor at the same time. There are often different tiers of engagement in a construction project.

4.2 Mainstream contractor

4.2.1 *General principles*

These are the businesses that are principally intended to operate CIS. These include businesses that undertake construction work and those that supply labour for construction work.

Within the definition of mainstream contractors are construction businesses, including foreign companies operating in the UK, as well as property developers undertaking work on buildings with a view to profit. However, they are distinct from property investors, unless their undertakings are such that they qualify as deemed contractors.

As well as work on buildings, mainstream contractors include those businesses involved in work on utilities, telecommunications and transport networks and infrastructure.

Gang leaders or gangmasters should also be regarded as mainstream contractors, for those workers that are being supplied who are genuinely self-employed. The same applies to labour agencies supplying workers if the contract for provision of labour to the contractor is with that agency.

The business status of the entity – sole trader or limited company – makes no difference to the definition of contractor and sub-

contractor. A sole trader may engage a limited company, in which case the company is still the sub-contractor to the sole trader contractor.

4.2.2 Example illustrating general principles

The end client engages a construction company, A plc, to build its new warehouse. That need not make the end client a contractor for CIS – that will be covered later in the chapter.

A plc may engage several other businesses; they may choose to outsource the landscaping, installation of drains, or any part of the envelope of the building itself. Let us say that the steel structure of the warehouse is put out to tender and won by B Ltd.

B Ltd becomes a sub-contractor to A plc, the contractor. This is the first time that B Ltd has worked for A plc, so A plc has to verify B Ltd for payments under CIS. B Ltd is found to have gross payment status.

B Ltd receives the plans and purchases the steel necessary from Z Ltd. Z Ltd is not a sub-contractor of B Ltd, because it is only a supplier of materials.

B Ltd looks at where its activities fit in the proposed time plan for the project. It owns the flatbed lorry to transport the fabricated parts of the steel structure to the site, but not the crane for its installation. B Ltd contacts X plc, a large plant hire company, to arrange for a crane to be on site for the days needed.

At this point, B Ltd may be a contractor. According to the CIS rules, if only the crane is supplied, then X plc is just that – a supplier. If X plc provides a crane operator, then X plc becomes a sub-contractor to B Ltd. There is a labour element and therefore this should be shown separately on the invoice from X to B and reported as such on B's monthly CIS return. B has to verify X. B is then both sub-contractor (to A plc) and contractor (of X plc).

There are two other scenarios here; if B Ltd's own employees are qualified to operate the crane, then X plc remains only a supplier and not a sub-contractor. If B engages a crane operator separately, the crane operator is a sub-contractor to B and must be verified. X plc is still only a supplier.

Due to the location and time constraints of the project, B Ltd decides to use two gangs of steel erectors. One will be made up of its own employees. The other will be sourced from a local provider, C, that B Ltd has used before. C is a sub-contractor to B Ltd, B Ltd is the contractor of C. B Ltd has paid C within the last two years, so there is no need for verification, but the record shows that C does not hold gross payment status.

C engages all his workers on a self-employed basis. Two of them, D and E, have worked only for C for several years. Alongside these two, C engages F and G to provide a gang of four workers. D, E, F and G are all sub-contractors to C. All four have been verified recently by C and are paid net.

To be clear on this, C is not a sub-contractor to A plc. His business relationship is with B Ltd. Similarly, D (and E, F and G) are not sub-contractors to A plc or B Ltd. Their business relationships are only with C.

The end client makes the first stage payment to A plc. If the end client is not a deemed contractor (covered later in the chapter), then there is no return to be made under CIS.

B Ltd makes its first application for payment to A plc. The quantity surveyor at A plc only approves part of the sum applied for and, after making a further deduction for retention, authorises this for payment. That lower sum which is actually paid is entered (net of VAT) on A's monthly CIS return without deduction of tax as a payment to a sub-contractor.

B Ltd receives an invoice for the first month from C. All is in order and being labour-only, there are no deductions for materials. Payment is made net of 20% tax to C and a deduction statement is issued. The payment and tax deducted are entered in B's monthly CIS return.

C pays D, E, F and G, having worked out what they are owed, deducts tax, and makes the appropriate entries in his monthly CIS return. C should issue his sub-contractors with deduction statements in each month when a payment is made.

4.2.3 Example illustrating variations

This example sets out the usual chain of operation. There is no jumping of links unless there is a change and direct link between

business entities. If, for example, B Ltd engages the steel erector G directly as a temporary replacement for an ill employee, then G leaves C and is then sub-contracting to B Ltd. If in doubt – it is down to who pays whom.

If, after the project is completed, C is investigated by HMRC and is found at a tax tribunal to have employed D and E, that makes no difference to the relationship between B Ltd and C. B Ltd engaged C to provide site labour – if those workers are employees or self-employed sub-contractors, it does not matter.

D and E, and for that matter HMRC, have no redress against B Ltd. Unless, that is, D and E can prove that C was entirely absent and they were under the supervision, direction, and control of B Ltd's staff – and even then, they would only be given employment status, not sub-contractor status.

The contractors A plc, B Ltd and C are involved in construction operations as defined by CIS. They are what is known as mainstream contractors.

4.3 Deemed contractors

4.3.1 Definition

What about those not in construction, but who incur costs on operations covered by CIS? The term “deemed contractors” is used to denote any person carrying on a business, or certain bodies, whose expenditure on construction operations exceeds specified limits.

The threshold for CIS was set in 2007 as an average of £1 million per year in the last three years. This was reviewed as part of the 2020 consultation; the new rules are that expenditure should be reviewed on a rolling monthly basis to cover the previous 12 months (much like turnover with VAT registration), but with the threshold now being £3 million.

Law: FA 2004, s. 59 (1), (2)