

## Mainstream and deemed contractors

The following guidance sets out the HMRC position on both 'mainstream' and 'deemed' contractors and clarifies the interpretation of payment exemptions under Regulation 22, SI2005/2045.

### Reason for this guidance

As a result of enquiries received, both internal and external, around the correct application of Regulation 22, SI2005/2045 (The Income Tax (Construction Industry Scheme) Regulations 2005), since its introduction in April 2007, and the correct interpretation of a contractor defined under s59(1)(a) and (l) FA/04, HMRC has now carried out a thorough review of the legislative background and policy intentions of these statutory sub-sections. (Extracts of the legislation concerned are reproduced at the end of this guidance).

### Impact of this guidance

This guidance introduces a change to the way HMRC has previously interpreted s59(1)(a) and (l) FA/04 since April 2007. In particular, this guidance affects the contractor status of certain businesses previously considered to be 'mainstream' that may now be considered as 'deemed'. As a consequence, a number of additional businesses may now be in a position to exempt certain of their payments under contracts relating to construction operations undertaken for the purposes of their own business.

### Background

Under Regulation 22, which came into effect in April 2007, certain payments made by 'deemed' contractors whose expenditure on construction operations relating only to their own property were taken out of the scope of CIS. This regulatory exemption applies **only** to contractors that come within s59(1)(l).

Under previous schemes, that is, prior to April 2007, there had been very little requirement to closely consider which contractor definition might apply to a particular business. This was because any business with more than £1m pa expenditure on construction would have had to operate the scheme in any event.

The 'mainstream' contractor definition under s59(1) (a) applies to **'any person carrying on a business which includes construction operations'**.

Previously, in addition to those businesses clearly within the mainstream of construction, HMRC considered that a number of other businesses also fell within s59(1)(a).

By re-visiting the background to the policy intention that supported the introduction of the 'deemed' contractor definition into the legislation in 1980, it is apparent that this was meant to apply to **all** those businesses not considered to be in the mainstream of construction. As a result, and with

some specific exemptions detailed below, HMRC now considers that **any** business that is not in the mainstream of construction (see details below) should be considered a 'deemed' contractor within CIS.

### **Mainstream**

**In addition to**, the obvious mainstream contractors such as building and construction businesses and property developers, the following types of business will **also** fall within the mainstream contractor definition (s59(1)(a)):

- Utilities (gas, electricity, water etc.);
- Telecommunications (undertaking works forming part of the land);
- Transport network & infrastructure (construction of, roads, motorways, railways, docks, harbours, and airports).

The above is intended to be helpful. It is not, and should not, be read as an exhaustive list.

### **Deemed**

S59(1)(b) – (l) FA/04 define those persons or bodies 'deemed' to be contractors within CIS. Only **businesses** are 'deemed' to be contractors by s59(1)(l). These will be non-construction businesses, such as large manufacturing concerns, department stores, breweries, banks, oil companies and property investors.

### **What 'deemed' contractor payments are not exempted by Reg 22?**

Reg 22 allows 'deemed' contractors to exempt construction payments **but only** 'in respect of construction operations relating to **property used for the purposes of the business** of that person...' This regulation also goes on to state that 'the property is not used for the purposes of the business of a person **if it is for sale or let**' (except where purely incidental) **'or is held as an investment by that person'**.

It is important to note that it is the **payment** and **not the business** that is exempted by Reg 22. Where businesses defined by s59(1)(l) are allowed to effectively 'de-register' from CIS, this is on the clear understanding that:

- any payments they make under a contract relating to construction operations will always relate to property used for the purposes of the business, and
- the payments will not relate to payments for construction operations to property that the business intends to sell, let or hold as an investment

Deemed contractors that have expenditure on construction operations in the normal course of their business, sometimes within CIS and sometimes exempted by Reg 22, should continue to operate within the scheme. Where this is the case either nil returns or periods of inactivity should be filed as appropriate.

## **Examples of payments made by deemed contractor businesses for construction operations not exempted under Reg 22**

1. A supermarket chain engages in a contract with a subcontractor to build them a new store in a development that will also include some social housing. As the social housing is to be let, the contract payment to the subcontractor falls within the CIS.
2. A property investor engages a subcontractor to carry out a £5m refurbishment to a recent property acquisition. As the property is held as an investment, the contract payment to the subcontractor falls within the CIS. (Note: Property investors will only be brought into CIS where their expenditure on construction operations exceeds £1m pa.)
3. An insurance company providing property insurance, directly engages subcontractors to carry out any repairs to the property of policy holders, rather than making payments to the policy holders themselves. The payments for construction operations made by the insurance company do not relate to property used for the purposes of their business. Therefore, contract payments made by the insurance company to the subcontractor fall within the CIS. (Note: Where the insurance company has expenditure on construction operations to property it uses for the purpose of its own business, the refurbishment of its head office building for example, or its own call centres, then these payments may be exempted under Reg 22).

## **Examples of payments made by deemed contractor businesses for construction operations that are exempted under Reg 22**

4. A retailer commissions the building of a new shop/store, or the refurbishment of a shop/store, to be used for the purpose of the business.
5. A company commissions the building of new office accommodation or refurbishment of office accommodation, to be used for the purpose of the business.
6. A business commissions the building of a new factory/industrial plant, or extension/alteration of an existing factory/industrial plant to be used for the purpose of the business.

**Remember**, where it is applicable, Regulation 22 exempts **only** the contract payment made by the business. It does not exempt the business itself, nor does it exempt the construction contract.

Where a subcontractor is engaged by a 'deemed' contractor business that is entitled to exempt payments to that subcontractor under Reg 22, the exemption **does not** continue to apply further along any contractual chain. If the subcontractor to the deemed contractor decides to engage another subcontractor they will become a contractor themselves defined under s57(2)(b)(i) FA/04 and CIS must apply. The majority of contractors in CIS are

contractors under this legislative subsection by virtue of this contractual arrangement.

**Legislation: Sections 59(1)(a) and (l) Finance Act 2004 and Reg 22, S.I. 2005/20145**

**Section 59, Contractors.**

This section applies to the following bodies or persons-

- (a) any person carrying on a business which includes construction operations;
- (l) a person carrying on a business at any time if-
  - (i) his average annual expenditure on construction operations in the period of three years ending with the end of the last period of account before that time exceeds £1,000,000

**Regulation 22.**

“22 – (1) A payment under a construction contract is not a contract payment if the payment is made by a person to whom section 59(1)(l) of the Act applies in respect of construction operations relating to property used for the purpose of the business of

- (a) that person, or
- (b) another company in the same group or of another company of which that company owns 50% or more of the shares.

(2) For the purpose of paragraph (1) –

- (a) property is not used for the purposes of the business of a person if it is for sale or to let (except where the sale or letting is purely incidental to the business of that person\*) or is held as an investment by that person;
- (b) in determining whether property is used for the purpose of the business of a person incidental use of that property by any other person is disregarded;
- (c) section 413(3)(a) of ICTA applies to determine whether two companies are in the same group.

\*(amended by SI2007/672).