

The Inland Revenue and the Construction Industry

Working together for a New Scheme

A Consultative Document
November 2002



The Inland Revenue and the
Construction Industry;
Working Together for a
New Scheme.

A Consultation Document by the Inland Revenue

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Code of practice on written consultation: the consultation criteria

- 1 Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.
- 2 It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
- 3 A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
- 4 Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others), and effectively drawn to the attention of all interested groups and individuals.
- 5 Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.
- 6 Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and reasons for decisions finally taken.
- 7 Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.

We confirm that these consultation criteria have and will continue to be followed.

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Timing and Contacts

This Consultation Document sets out proposals for a new scheme for the taxation of the Construction Industry and invites you to comment on them. It is published with a Partial Regulatory Impact Assessment, which can be found in Part 2. This considers the impact of the new proposals compared with the existing scheme.

We would welcome feedback on the questions outlined. We would appreciate it if you could indicate in your response how you are involved in CIS – for example, whether you are a contractor, deemed contractor, subcontractor, accountant etc. Responses by post or email should be sent to:

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Comments should reach us by 28th February 2003. Your response may be made public unless you tell us you would like us to keep it confidential. If you have any questions about this Consultation Document, please also contact Chris Hasler.

If you have any complaints about any element of the consultation process leading from the issue of this document then please write to Paul Heggs, Inland Revenue, New Wing, Somerset House, Strand, London WC2R 1LB. Alternatively, you can contact him by telephone (020 7438 6302), by fax (020 7438 6431) or by email at paul.heggs@ir.gsi.gov.uk.

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Executive Summary

The Inland Revenue and the Construction Industry; Working Together for a New Scheme.

A special tax deduction scheme for the Construction Industry has existed since 1972 in order to deal with problems, which were endemic in the Industry, of engaging workers on a "cash in hand" basis, coupled with a poor record of complying with tax obligations. The current Construction Industry Scheme (CIS) has been in place since 1999, but it retains the basic structure of its predecessor, relying on paper vouchers to evidence payments between contractors and subcontractors.

On introduction in 1999, the current CIS suffered from early problems (for example, over voucher supply) and, although it was developed with close involvement of the Industry, concerns continue in the Industry about its cumbersome processes and the costs to businesses of complying with the rules and requirements.

The Government has listened to these concerns and has asked the Inland Revenue to develop proposals to modernise the scheme. The Government has set three broad aims that a revised scheme should meet. They are:

- 1 To reduce the regulatory burden of the scheme on construction businesses;
- 2 To improve the level of compliance by construction businesses with their tax obligations;
- 3 To help construction businesses to get the employment status of their workers right.

In developing proposals for reform, we have undertaken a detailed analysis of CIS to identify the features that businesses find most difficult. This has shown that the requirement for completing and processing vouchers is a key area of concern. These processes are complex and can be confusing and expensive in both time and effort, particularly where a person has to travel to a contractor's premises to present evidence of identity to enable payment to be made for work done.

We have therefore focused on options for the future which address these issues by developing an approach which is cheaper and simpler for construction businesses to comply with. We have also looked at ways of improving our ability to police the scheme effectively and to identify and tackle those businesses that fail to comply with their tax obligations.

The proposals described in this document will significantly improve the scheme.

Many businesses will benefit both from reduced costs of operating the scheme and, if our ability to police the Industry is improved, from less unfair competition from those who currently fail to comply fully with their tax obligations.

In outline the main proposals are:

- To replace the Registration Cards (CIS4) and Gross Payment Certificates (CIS6 and CIS5) used in the current scheme with a verification service;
- To introduce a new employment status declaration;
- To replace the vouchers in the current scheme with periodic returns;
- To replace our current computer system with a new system capable of supporting the use of 'e' services, for example, communication over the Internet, and allowing us to make sure the scheme is complied with.

Taken together, these proposals will create considerable savings for many within the Construction Industry, by reducing the amount of work involved in operating the scheme. In particular, the removal of the need to travel to present CIS4 Registration Cards and CIS6 Gross Payment Certificates, coupled with the reduced amount of paperwork will generate significant savings in administrative costs for business.

We now need your views on these proposals to make sure that they accurately reflect the needs of the Industry. At the end of the consultation period, we will carefully analyse your responses and they will be used in the further development of the policy. We intend to run a number of focus groups during the consultation period to discuss some of the issues in the proposed new scheme – if you would like to be involved in one of these, please contact Chris Hasler as soon as possible. We would particularly encourage small businesses to attend the focus groups. If the proposals are implemented, it is expected that there will need to be further consultation with the Industry on the draft of the legislation.

Part 1

Chapter 1

The Current Scheme – the Concerns

The Construction Industry Scheme

- 1 The Construction Industry Scheme (CIS) was introduced in August 1999 and built largely on the principles of the previous deduction scheme, first introduced in 1972. Its aim was to improve compliance compared to the 1972 scheme. The main changes were to:
 - Introduce the CIS4 Registration Card;
 - Reduce the number of subcontractors who qualified for a Gross Payment Certificate (CIS6 or CIS5) by introducing a turnover test;
 - Introduce vouchers for all payments made to all subcontractors.

- 2 The main features of the current scheme are that:
 - Businesses, (whether companies, partnerships or self-employed individuals) working on construction operations must be paid under the rules of the CIS. The person commissioning the work is known as a contractor, the person doing the work is known as a subcontractor. Many businesses are both contractors and subcontractors;
 - Most subcontractors receive a Registration Card (CIS4). This means that a contractor must make a deduction, currently at a rate of 18%, from payments made to that subcontractor. For individuals and partnerships, this deduction is taken on account of the subcontractor's eventual tax liability and class 4 National Insurance Contributions (NIC's). For companies, it is on account of their liabilities as an employer or contractor;
 - Subcontractors, who can pass certain statutory business, compliance and turnover tests, qualify for a Subcontractors Tax Certificate (CIS6). This Certificate entitles them to receive payments in full without any deduction being made by the contractor;
 - Subcontractors who hold either Registration Cards (CIS4) or Subcontractors Tax Certificates (CIS6) must present their Card or Certificate in person to contractors, before they can receive payment for work done that comes within CIS;
 - Companies and partnerships can apply for a Construction Tax Certificate, CIS5 or CIS5 (Partner). Unlike the CIS4 and CIS6, this Certificate does not need to be presented to the contractor before payment is made (details can be certified

by post instead). To qualify, they must pass all the tests for a CIS6 and have a turnover of at least £1 million (or a compelling business case showing that a CIS6 would be inappropriate - for example, because of the number of vouchers they use or the amount of travelling they need to do to present the Certificate in person);

- All payments made by the contractor to the subcontractor must be supported by vouchers. When paying a subcontractor holding a CIS4 or CIS5, the contractor is responsible for completing the voucher. In the case of a CIS4 holder, a copy must be given to the subcontractor and to us, while in the case of a CIS5 holder, a copy need only be sent to us. A subcontractor holding a CIS6 must partly complete a personalised voucher and send it to the contractor, who finishes it. The contractor then sends copies to the subcontractor and to us.

Charts showing the current processes can be found in Appendix B on pages 26 and 27.

Early Problems

- 3 Following the introduction of CIS, a number of changes were made to its operation to tackle teething problems. In particular, the arrangements for supplying vouchers and for their submission to us were revised to remove bottlenecks and make the process more efficient and cost effective.
- 4 The Government has also responded to two further complaints from the Industry by making changes to the CIS rules:
 - The difficulty in obtaining a CIS5 Certificate. During 2000, the qualifying turnover threshold for getting a CIS5 Certificate was reduced from £5 million to £3 million, then to £1 million and, from April 2001, applications for CIS5 Certificates from partnerships were accepted. Over 2000 companies have obtained CIS5s as a result of these measures;
 - The cash flow problems faced by small companies receiving payments under deduction. Since April 2002, companies that have deductions made from their payments have been able to offset these deductions against other payments that they have to make to us as an employer or contractor. We estimate that around 20,000 companies may currently be benefiting from an improvement in their cash flow as a result of this measure.

Concerns about the current scheme

- 5 Despite these changes, surveys conducted with the Construction Industry and complaints from specific businesses have shown there are still several areas of concern:
 - (i) Cards (CIS4) and Certificates (CIS6 and CIS5) - complaints continue on a range of issues connected to the Cards and Certificates:
 - Registration Card (CIS4) holders and Subcontractors Tax Certificate (CIS6) holders complain that they have to travel to present their Cards and Certificates

to the contractor. Depending on the type of work and distances covered, this can substantially increase business costs;

- The Registration Card (CIS4) is (incorrectly) treated by some in the Industry as an indication that the subcontractor holding it is self-employed. As a consequence, some contractors do not independently check the employment status of the subcontractor once they have been presented with a Registration Card (CIS4). Some in the Industry claim that this leaves those businesses that correctly comply with their tax obligations at a commercial disadvantage;
- There is also some evidence of fraudulent misuse of CIS documents - for example, Registration Card (CIS4) holders who purchase a Subcontractors Tax Certificate (CIS6) and the associated vouchers in order to fraudulently avoid a deduction on their payments. This can also affect the competitiveness of compliant businesses.

(ii) Vouchers - although current arrangements for voucher supply appear generally to operate satisfactorily, there are concerns about the complexity of the voucher chain and the cost of complying with the process. For example, the process for completing and filing vouchers depends on the type of Card (CIS4) or Certificate (CIS6 and CIS5) the subcontractor holds (see paragraph 2). This complexity means that the voucher process can be difficult to understand and expensive to administer.

(iii) Not compatible with modern technology, such as email and the Internet - it is not possible to submit the vouchers and end of year return over the Internet, like SA Returns. Although some vouchers can be submitted by Electronic Data Interchange (EDI), this is generally only used by the largest of construction businesses.

(iv) General complexity of processes and rules - although we have made changes to reduce the complexity of CIS and introduced special helplines to give advice to contractors and subcontractors, the Industry still consider the scheme to be difficult to administer. For example:

- The nature of the tests (turnover, compliance and business) which subcontractors must pass to qualify for a Subcontractors Tax Certificate (CIS6);
- The precise scope of the scheme is not readily understood.

6 The following two Chapters set out our proposals for tackling these concerns.

Chapter 2

Tackling the Concerns – the Reform Proposals

7 The Government have listened to the concerns outlined in Chapter 1 and consider them so fundamental as to warrant a thorough review of the scheme. The Government have set three broad aims that a revised scheme should meet. They are:

- 1 To reduce the regulatory burden of the scheme on construction businesses;
- 2 To improve the level of compliance by construction businesses with their tax obligations;
- 3 To help construction businesses to get the employment status of their workers right.

8 In taking this forward, we have looked at several options for change. These range from minor change, that would involve little more than adapting the current scheme to enable electronic communication, through to its complete abolition:

- Electronic Communication

We have looked at ways information can be transmitted electronically – for example, by telephone or over the Internet. We have concluded that, although modern technology could improve the processing of vouchers, it would not resolve many of the underlying problems that concern the Industry. We therefore rejected this option;

- Complete Abolition

This would clearly reduce the regulation on the Industry, but it would involve unacceptable risks of tax loss. Although thirty years have passed since the original scheme was introduced, the reasons for its introduction remain part of construction business culture in some quarters. For example, there continue to be large numbers of itinerant workers who are often paid in cash and experience of operating CIS shows that there are some less scrupulous businesses, who set out to avoid their tax obligations. So abolishing the scheme without a replacement would not meet the Government's aim of improving tax compliance by construction businesses. We therefore also rejected this option.

Reform proposals

9 We believe that the proposals that follow best meet the aims of the review and respond directly to the concerns of the Industry about the current scheme. The main proposals are:

- To replace the Registration Cards (CIS4) and Gross Payment Certificates (CIS6 and CIS5) in the current scheme with a verification service;

- To introduce an employment status declaration;
- To replace the vouchers in the current scheme with periodic returns;
- To replace our current computer system with a new system capable of supporting the use of 'e' services, for example, communication over the Internet, and allowing us to make sure the scheme is complied with.

1 0 For ease of reference, the proposals have been broken down into four main processes - registration; verification; return of information and payment; and end of year return process. These are followed by some information on the new computer system. Charts showing the proposed processes can be found in Appendix C on page 28 and 29.

1 1 We should emphasise that these processes are still at a very early stage in their development. With the help of the Industry, we need to add more flesh to the bones. We believe that joint-working in this way will help us to develop a new scheme that works well for both the Construction Industry and for us.

Registration

1 2 We envisage little change to the current registration process that applies to construction businesses, because feedback from the Industry suggests that this process already works well. Contractors will follow the same registration process as they do under CIS - they will continue to be able to notify us face to face or over the telephone that they want to contract subcontractors for work that falls within the scheme. However, under the new proposals, contractors will also be able to register with us over the Internet.

1 3 All subcontractors (including companies) will continue to register with us, if the scheme applies to the work they are undertaking. This will continue to involve a subcontractor completing an application form and attending a local tax office with two proofs of identity, showing a current address and evidence of their National Insurance Number. Alternatively, under the new scheme, we are proposing that subcontractors will be able to register over the telephone or the Internet.

Verification

1 4 Once subcontractors have registered, they will no longer receive any documentation, such as a Registration Card (CIS4) or Gross Payment Certificate (CIS6 or CIS5). We think that this change will significantly reduce the burden on subcontractors who currently have to travel to present their documentation to contractors.

1 5 However, we believe that we must still be told about the contracts that exist between contractors and subcontractors. We need this information for compliance

purposes, so that we know who is being paid by whom.

1 6 With this in mind, we propose to introduce a new verification service. This service will need to be accessed by contractors either by telephone to a contact centre, via the Internet or in writing, when they wish to take on a subcontractor.

1 7 When contacting us regarding a subcontractor, the contractor will need to:

- Identify the subcontractor by quoting his or her name and National Insurance Number, for example; and
- Confirm that the employment status of the subcontractor has been checked.

1 8 The second of these two points is not a new concept. It is a current requirement and CIS does not apply if the contract is one of employment (if this is the case, then the contractor must operate PAYE and class 1 NIC's). However, under the new proposals, we will require the contractor to declare to us that the employment status of the subcontractor has been considered and there will be a penalty regime for contractors who make false declarations.

1 9 Once we have received these pieces of information, we will advise the contractor whether the subcontractor has registered with us and, if so, whether to pay gross or under deduction. We will also issue a reference to the contractor and maintain a record of the verification approach.

2 0 If contact is made by telephone or via the Internet, we will aim to give an immediate response.

Return of information and payment

2 1 As now, the contractor will pay deductions taken from payments to subcontractors to us at regular intervals.

2 2 Under the new proposals, there will be no vouchers. Instead, contractors will need to submit statutory periodic returns to us, detailing the subcontractors they have paid, how much they have paid (and deducted) and any materials provided by the subcontractors. These returns will be sent directly to us periodically, for example, monthly or quarterly.

2 3 So that subcontractors can check the information given on the periodic returns by contractors, we will send a statement to them confirming the amounts of payment and tax deducted as reported on the periodic returns. Subcontractors will need to check these amounts against their payment slips to ensure they are correct. This is an important step for subcontractors, as these statements will be linked to their SA tax records and will therefore play a key part in determining the amount of tax

they are expected to pay at the end of the tax year. Subcontractors should therefore report any discrepancies to us.

- 2 4 The periodic return may be submitted either on paper or electronically and we plan to discuss with software providers arrangements to approve software which would make the electronic submission of returns easier for contractors.

End of year return process

- 2 5 Because statutory periodic returns will give us all the information we need during the year, we will no longer need an end of year return relating to the scheme (such as the CIS36) from the contractor. However, contractors and subcontractors must still declare their personal income or company profits on a Tax Return.

The new computer system

- 2 6 These proposals will need to be supported by a new computer system which will, amongst other things, enable contractors to submit documentation via the Internet and support the new verification service.

- 2 7 It will also be developed in such a way that we can check that construction businesses are operating the scheme correctly and timeously. The system will be able to risk assess subcontractors and contractors and will provide us with trend analysis and risk profiles. This will enable our compliance officers to tackle non-compliance more quickly and more effectively than at present.

Conclusion

- 2 8 In summary, we propose that:
- a The registration process will remain the same as it is now. The only proposed change is that there will be more flexibility as to the method of registration. As this process is not very different from the current system, we estimate that the impact on business will consist of a small reduction in costs for contractors and subcontractors as a result of the new facility for electronic registration.
 - b A verification process will replace Cards (CIS4) and Certificates (CIS6 and CIS5). This will give substantial savings in compliance costs for all

subcontractors. Because contractors will be responsible for verifying each of their subcontractors, their cost of complying with this aspect of the process will increase. We recognise this, and so want to work with contractors to make this process as straightforward as possible to minimise costs for business. However, this process will give contractors greater assurance that the subcontractors they take on are compliant and also that we will be able to track down the non-compliant effectively.

- c An employment status declaration will be introduced, confirming that contractors have considered the employment status of the subcontractors they are taking on. This will be an important step towards dealing with concerns about "false" self-employment in the Industry. However, we do not believe it would be appropriate (as some people have suggested) to move all Registration Card (CIS4) holders on to PAYE. This is because employment status is an issue that impacts on all industries, not just construction and it would be wrong to look at it in isolation on construction.
- d Periodic returns will replace vouchers and they will be able to be submitted on-line. This will reduce costs for both contractors and subcontractors, by reducing the amount of time they have to spend dealing with paperwork.
- e Contractors will no longer have to complete an end of year return for the scheme.
- f We plan to introduce a new computer system to help us find the non-compliant in the Construction Industry more effectively. This will also help both compliant contractors and subcontractors who currently complain about unfair competition from those businesses who fail to comply fully with their tax obligations.

2 9 Taken as a whole, these proposals will reduce the cost of complying with the scheme for both contractors and subcontractors. They will also help us to find and deal with the non-compliant.

3 0 In conclusion, we believe that the reform proposals in this document fulfil the Government's objectives for this review by:

- Reducing the regulatory burden of the scheme on construction businesses;
- Improving the level of compliance by construction businesses with their tax obligations;
- Helping construction businesses to get the employment status of their workers right;

and respond directly to the concerns described in Chapter 1.

3 1 We welcome your views on these proposals. In particular, we are interested in:

A1 - Contractors

- a How would these changes affect the amount of work your business has to do to

operate the scheme?

- b What, if any, practical difficulties can you see in operating the proposed scheme?
- c How would a move to electronic communication affect you?
- d Would you prefer to communicate with us in writing, over the telephone or via the Internet?

A2 - Subcontractors

- a How would these changes affect the amount of work your business has to do to operate the scheme?
- b What, if any, practical difficulties can you see in operating the proposed scheme?

A3 - General

- a We want to be able to offer the best possible help if these proposals are implemented - which of the following would be of most assistance:
 - Written guidance?
 - Training seminars?
 - On-line training material?
 - Visits from our Business Support Teams?
 - Anything else?
- b Will these proposals help businesses to get employment status right?
- c Will these proposals make it easier for businesses in the Industry to pay the right amount of tax?

Chapter 3

Other Issues

- 3 2 This section seeks your views on three particular rules in the current scheme. The information you give us will help inform the further work we need to do on the development of the new scheme.

Deduction rate

- 3 3 The deduction rate is currently set at 18% of the payment (net of the direct cost of materials). This is on account of the eventual tax and class 4 National Insurance liability of subcontractors for individuals and partnerships, or the amount of employer and contractor liabilities payable for companies. The rate was set at 18% from April 2000 after extensive research, as it represented the average liability of subcontractors then paying tax as individuals and partnerships. However, we have had complaints from the Industry that it is both too high for some and too low for others.

- 3 4 Some Trade Unions have also complained that the deduction rate is lower than the combined tax and National Insurance applied to employees. They have suggested that this, together with the relative ease of obtaining a Registration Card (CIS4), could be providing an incentive for some contractors to classify falsely their workers as self-employed rather than employed in order to reduce costs.

B1 - Deduction rate

- a Is the deduction rate set at the most appropriate level?
- b Does the deduction set at 18% help you to manage the amount of tax you need to pay as a self-employed person?
- c After calculating your tax liability, do you generally find that you have tax to pay or do you get a repayment and which would you prefer?
- d If you are a company, do you still have liabilities to pay as an employer or contractor each month or do you have CIS deductions to carry forward?

Turnover test for Gross Payment Certificates (CIS6)

- 3 5 The current threshold of £30,000 (per participator) to qualify for a Gross Payment Certificate (CIS6) was set after considerable discussion with the Industry. It was felt to be a good balance between the need to set the limit low enough to avoid having a negative impact on genuine businesses, but high enough to prevent substantial numbers of labour-only subcontractors from being able to qualify for a Gross Payment Certificate (CIS6). To help small businesses to qualify, we allowed businesses to use any construction income to qualify towards the threshold, rather than just that income that fell within the scheme. The threshold had widespread approval from Industry bodies and Industry Trade Unions.

3 6 Nevertheless, some representations have been received that genuine businesses with a turnover of less than £30,000 (per participator) should be able to qualify for a Gross Payment Certificate (CIS6). The argument made in support of such representations is that the small businesses that cannot pass the turnover test must have a Registration Card (CIS4), despite being able to pass the compliance and business tests. They claim that this puts them at a commercial disadvantage compared to businesses that have a Gross Payment Certificate (CIS6) as they cannot compete for contracts as readily.

B2 - Turnover test

- a What do you think of the turnover test? Is it set at the right level?
- b If not, what might be a suitable alternative, and for what reasons?

Scope of the scheme

3 7 The borderline between what does or does not constitute construction operations is not always clear. Guidance on the current rules relating to scope can be found in the leaflet CIS 340 - available on the Internet or from local tax offices. An example of a borderline activity is where a tree is felled as part of forestry work. This is not a construction operation. But if a tree is felled as part of a site clearance it is. We think there are a number of issues here:

B3 - Scope of the scheme

- a Have we got the general scope of the scheme right? Is there any merit in widening the scheme?
- b Are there grey areas that require clarification?
- c Would you find it easier if our legislation more closely resembled other legislation that you are used to when deciding what construction work is, for example, the Health and Safety at Work Act or the Construction and Regeneration Act? If yes, what are the reasons?

Part 2

Partial Regulatory Impact Assessment (RIA)

Introduction

- 1 This Partial Regulatory Impact Assessment considers the costs and benefits of the proposed changes to the Construction Industry Scheme outlined in the Construction Industry Scheme Consultation Document, November 2002.

- 2 The main proposals are:
 - To replace the Registration Cards (CIS4) and Gross Payment Certificates (CIS6 and CIS5) used in the current scheme with a verification service;
 - To introduce a new employment status declaration;
 - To replace the vouchers in the current scheme with periodic returns;
 - To replace our current computer system with a new system capable of supporting the use of 'e' services, such as communication over the Internet, and allowing us to make the scheme easier to comply with.

- 3 These new proposals will replace the current CIS.

Purpose and intended effect

- 4 The new proposals address the concerns the Industry have about the current scheme and fulfil three objectives:
 - 1 To reduce the regulatory burden of the scheme on construction businesses;
 - 2 To improve the level of compliance by construction businesses with their tax obligations;
 - 3 To help construction businesses to get the employment status of their workers right.

Risks

- 5 The main risk associated with the current CIS is that if changes are not made, then the problems currently experienced by the Industry will continue and may worsen. To overcome this risk, the Government has asked the Inland Revenue to develop reform proposals.

- 6 There is a further risk if the new reform proposals are implemented. If this process does not go as smoothly as planned, then there is a risk that different problems will arise in administering the new scheme and that additional costs will be incurred by the Industry in attempting to combat this. To overcome this risk, we propose to manage the implementation of the proposals strictly and ensure that we provide the necessary guidance and training for the Industry and our own staff in good time.

Assessment of the impact of the new proposals

- 7 We have made an initial assessment of the impact of the new proposals as they are envisaged at this stage. As the design of the new scheme is refined through consultation and development, our assessment may change. This will be reflected in a Final Regulatory Impact Assessment if the proposals are taken forward into legislation.

- 8 We would welcome your views on the impact of the new proposals.

Benefits of the reform proposals

- 9 The system that is proposed will introduce three significant deregulatory changes to the way the scheme currently operates. The Consultation Document goes into greater detail on these changes and how the new scheme might look in its entirety. The three deregulatory changes are described below:

- i Replacement of Cards and Certificates with a verification service. Under the existing rules, Registration Card (CIS4) and Subcontractors Tax Certificate (CIS6) holders have to travel to present their documents. Under the new proposals, these Cards and Certificates will be replaced by a verification service, where a contractor contacts us to verify that a subcontractor has registered in the scheme and to check whether he or she should be paid gross or net of deduction. This then will remove the need to travel to present as under the current scheme;
- ii Replacement of vouchers with a periodic return. The Industry consider the amount of paperwork required by CIS to be onerous. To resolve this, we propose that the vouchers will be replaced with returns that contractors have to complete on a periodic basis for their subcontractors;
- iii Widening the methods of communication. Under the new proposals, those operating the scheme will be able to contact us by telephone and over the Internet.

- 10 The main benefits of the proposals are:

- A reduction in the time and resources businesses will need to take to comply

with the scheme. This will result in a reduction in the costs associated with the scheme. Taking the new proposals as a whole, we believe that they could result in a reduction in the costs of complying with the current scheme of between 50% and 70% - an annual net reduction of between £25 million and £75 million. The proposals will benefit subcontractors more substantially than contractors but both should see a net saving. A brief summary of how these figures were reached can be found in Appendix D on page 30.

- An increase in Exchequer revenues and productivity. It is anticipated that the new system will lead to modest increases in Exchequer revenues if it is implemented successfully. The increase in revenues will arise from increased levels of compliance and reduced compliance costs enabling contractors and subcontractors to do more work, thereby improving productivity.

Inland Revenue costs

- 1 1 We estimate that it will cost us in the region of £40 million to implement the proposals outlined. This will cover the costs associated with putting in place the necessary IT systems, other capital costs and staff training for the above options.

Implementation costs

- 1 2 As would be the case for any significant change to the tax system, the proposals will involve imposing some initial start up costs and some ongoing annual compliance costs on our customers, associated with the introduction of the new proposals. Initial compliance costs will arise through contractors and subcontractors needing to spend time becoming familiar with the details of the new system and through making changes to computer files and manual filing systems.
- 1 3 Some contractors and subcontractors will incur costs when training their employees in how to operate the new system. Where 'delegated budgeting' is in place the training costs are likely to be higher. Delegated budgeting occurs when a specific subsidiary part of a contractor is given its own allocated budget to spend on construction (or any other area). The subsidiary would be able to hire subcontractors of its own choice and pay them directly - therefore, the subsidiary's administrators would need training on the new scheme, as (presumably) would those of the contractor. Hence the training costs would be greater than if the contractor administered everything itself.
- 1 4 Our initial estimates are that the total initial compliance costs might amount to between £25 million and £75 million for the Industry as a whole. This breaks down to a figure of between £10 million and £30 million for contractors and

between £15 million and £45 million for subcontractors.

- 1 5 All of these costs will be part of the setting up and gaining understanding of the new processes and so will be one-off costs. We will endeavour to reduce these one-off costs as much as possible by providing guidance and other help (for example, through our Business Support Teams). Once the systems are in place and the training complete, we believe that these proposals will significantly reduce compliance costs by the second year after implementation.

Securing compliance

- 1 6 Under the current scheme, a proportion of our compliance resource is spent on helping the Industry to operate the scheme correctly. For example, time and money is spent on ensuring that vouchers are completed and used properly. It is envisaged that the new proposals which are simpler to understand and operate will mean that compliance resource can be re-deployed to policing the non-compliant within the Industry.

- 1 7 A key part of the proposed arrangements is the new computer system, which will allow us to risk assess contractors and subcontractors within the scheme. The new system will be able to analyse trends in data provided through the returns submitted by contractors and will also be able to profile risk across the Industry. This will mean that compliance resource within the Inland Revenue can more accurately and efficiently target the non-compliant.

Competition impacts

- 1 8 By significantly reducing the costs of operating the scheme, the reforms will increase the competitiveness of the Construction Industry relative to other industries in the UK.

Impact on small business

- 1 9 The current CIS requires CIS4 and CIS6 holders to travel to present these documents for inspection by contractors, whilst those with CIS5 Certificates do not have to do so. This will have put many of the larger subcontractors (i.e. those holding CIS5s) at a competitive advantage, compared to smaller ones, as they do not incur costs associated with this. Introducing the verification service will therefore help many smaller subcontractors by removing this requirement.
- 2 0 The aim of the consultation exercise is to help ascertain the impact on businesses of all sizes, but we are especially keen to reach the many construction firms that are small in size. Small businesses are encouraged to send in their comments on the Consultation Document and their views as to how the proposals will impact upon their business as soon as possible.

2 1 We also intend to run a series of focus groups. At least one of these will look specifically at issues relating to small businesses and what effect the new proposals will have on them - please let us know if you would like to be involved in this.

2 2 We have also established links with the Small Business Service and it is our intention to involve them at every stage of the consultation and beyond.

Consultation

2 3 This Partial RIA forms part of a wider Consultation Document issued by the Inland Revenue alongside the 2002 Pre Budget Report, at the start of a consultation period that ends on 28th February 2003. This consultation covers options for changing the Construction Industry Scheme. We are looking for responses from a wide range of individuals, businesses, companies and other organisations to assist us in understanding the needs and requirements of those individuals and groups currently within CIS.

2 4 We welcome comments on the Partial RIA and, in particular, on the assumptions we have made regarding initial start up costs and ongoing annual savings once the new scheme is running.

2 5 In addition to this Consultation Document, we will also be arranging a number of focus groups during the consultation period to discuss the proposed new scheme.

Part 3

Appendices

Appendix A – Summary of Questions Posed

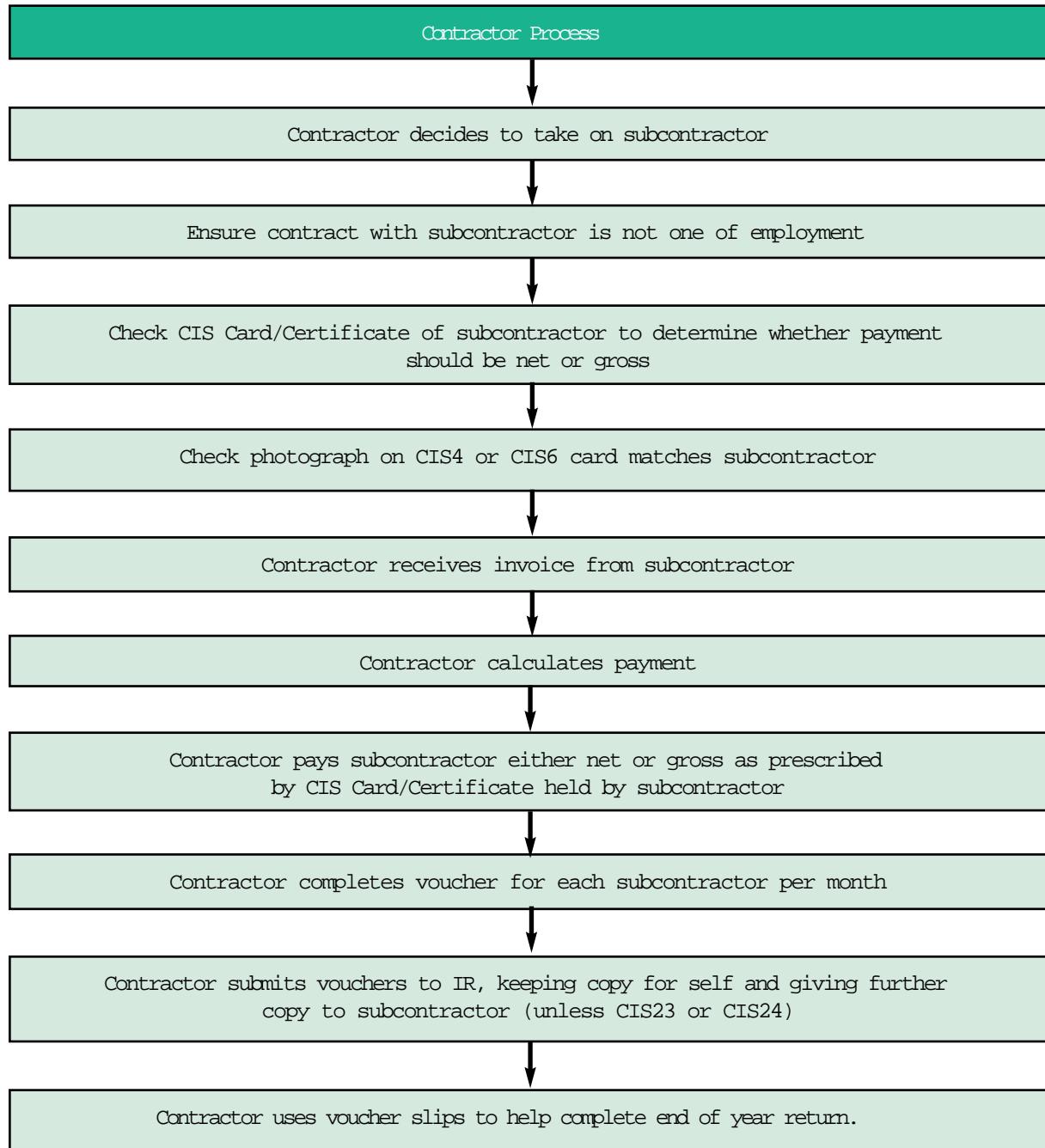
A1 – Contractors

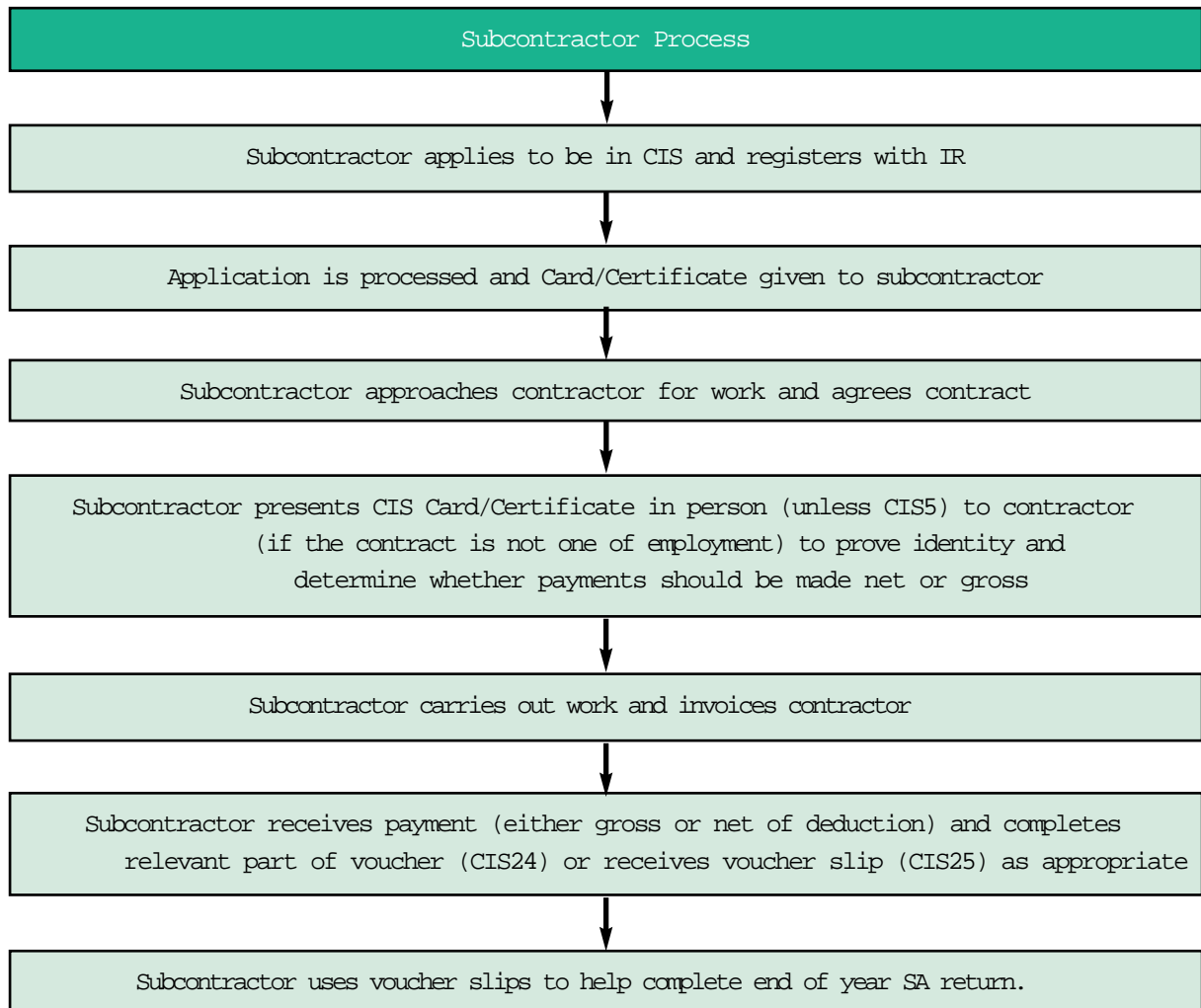
- a How would these changes affect the amount of work your business has to do to operate the scheme?
- b What, if any, practical difficulties can you see in operating the proposed scheme?
- c How would a move to electronic communication affect you?
- d Would you prefer to communicate with us in writing, over the telephone or via the Internet?

A2 – Subcontractors

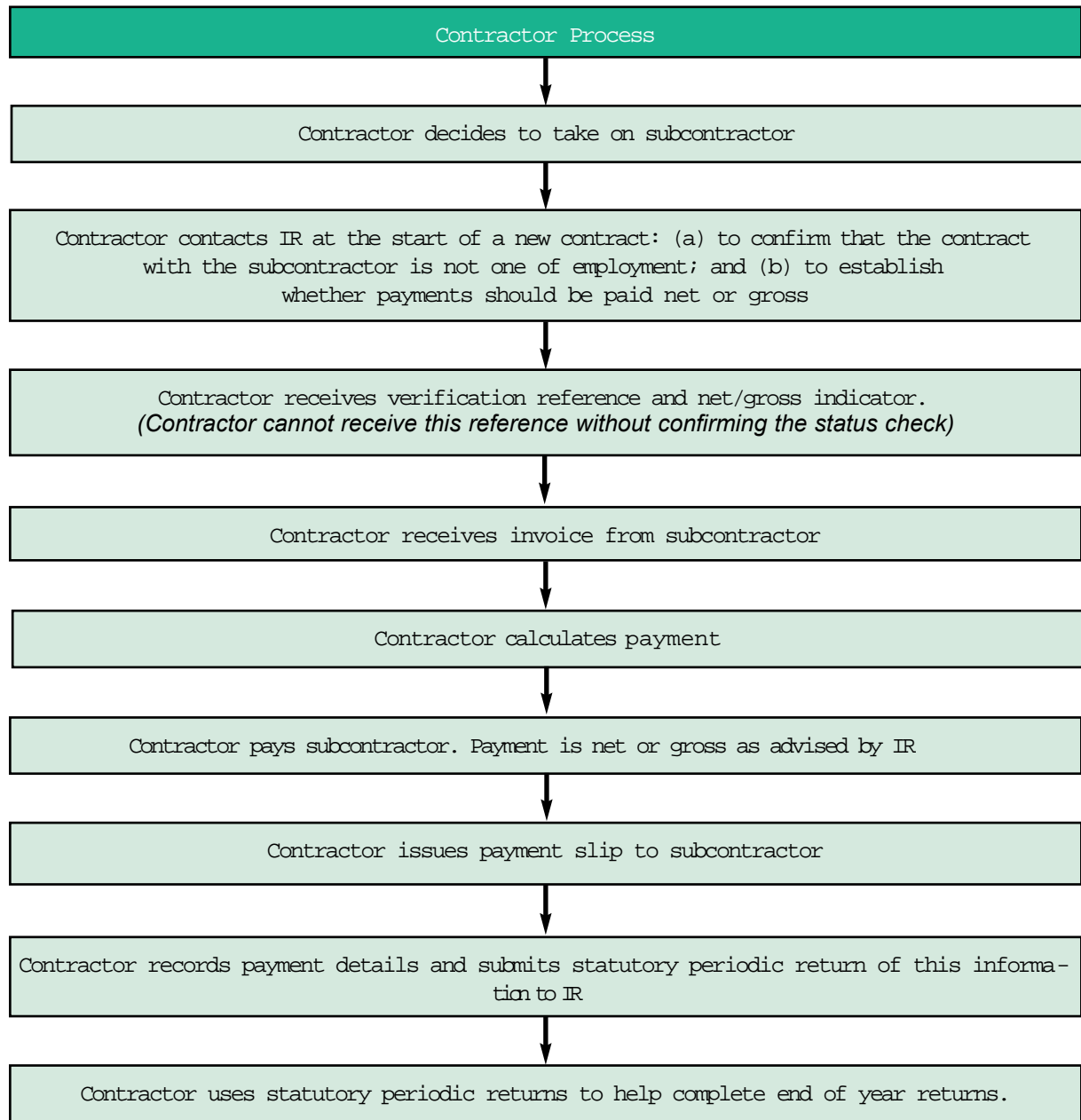
- a How would these changes affect the amount of work your business has to do to operate the scheme?
- b What, if any, practical difficulties can you see in operating the proposed scheme?

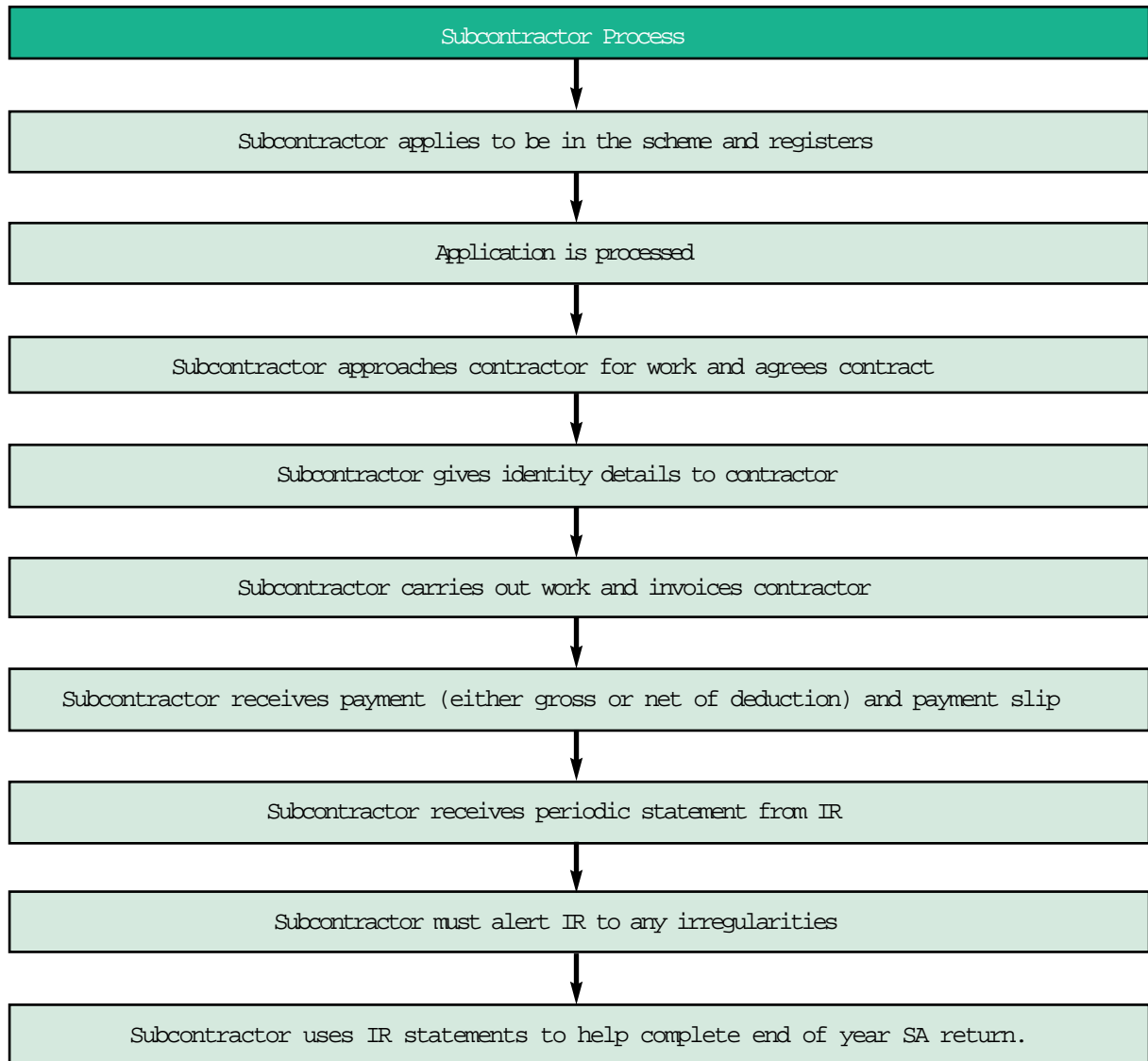
A3 - General





Appendix C - Flowcharts of Procedures for Contractors and Subcontractors under the New Scheme





Appendix D: Summary of Methodology Used to Calculate the Compliance Cost Estimates in the Regulatory Impact Assessment

1. In order to calculate the estimates of the effects of the reform proposals outlined in Chapter 2 of the Consultation Document on contractors' and subcontractors' costs of complying with the scheme, it was necessary to look at:
 - Compliance costs associated with operating the current CIS;
 - Compliance costs associated with operating the new proposals;
 - And one-off compliance costs associated with making preparations in order to operate the new proposals.

2. To estimate these, it was necessary to identify all of the relevant factors which contribute to the Industry's compliance costs and then to try to estimate the particular compliance cost implications of each of these factors. We needed to consider the amount of time it would typically take to do all of these different things and what the cost of that time would be. We also needed to consider what the cost implications would be in terms of spending on other resources, for example, travelling to present Cards (CIS4) and Certificates (CIS6).

3. It is not possible to do this with great accuracy given that the quality and scope of data and information available about the costs associated with the current scheme is limited. For this reason, the estimated compliance cost effects are given in fairly wide ranges. In particular, the estimated reduction for businesses in compliance costs of £25 million to £75 million given at paragraph 10 of the Partial Regulatory Impact Assessment, is calculated by applying the range of savings (in cash terms) to a range of possible compliance costs for the current scheme. Although it has not been possible to identify an exact level of savings to be gained from these proposals, we believe that the potential savings for business would be somewhere within that range.

- a We want to be able to offer the best possible help if these proposals are implemented – which of the following would be of most assistance:
- Written guidance?
 - Training seminars?
 - On-line training material?
 - Visits from our Business Support Teams?
 - Anything else?
- b Will these proposals make it easier for businesses in the Industry to pay the right amount of tax?
- c Will these proposals help businesses to get employment status right?

B1 – Deduction Rate

- a Is the deduction rate set at the most appropriate level?
- b Does the deduction set at 18% help you to manage the amount of tax you need to pay as a self-employed person?
- c After calculating your tax liability, do you generally find that you have tax to pay or do you get a repayment and which would you prefer?
- d If you are a company, do you still have liabilities to pay as an employer or contractor each month or do you have CIS deductions to carry forward?

B2 – Turnover Test

- a What do you think of the turnover test? Is it set at the right level?
- b If not, what might be a suitable alternative, and for what reasons?

B3 – Scope of the Scheme

- a Have we got the general scope of the scheme right? Is there any merit in widening the scheme?
- b Are there grey areas that require clarification?
- c Would you find it easier if our legislation more closely resembled other legislation that you are used to when deciding what construction work is, for example, the Health and Safety at Work Act or the Construction and Regeneration Act? If yes, what are the reasons?

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