

REGULATORY IMPACT ASSESSMENT FOR CONSTRUCTION INDUSTRY SCHEME

Introduction and background

1. The Construction Industry Scheme is an administrative scheme that applies to those working in the Construction Industry. The general purpose of the scheme is to ensure that those who work in the Construction Industry pay the right amount of tax and Class 4 National Insurance.
2. Contractors and subcontractors who work in the Industry and whose work is covered by the scheme must register with the Inland Revenue. Subcontractors are then given either a Registration Card or, if they pass each of three statutory tests, a Tax Certificate. The three tests are the business test, the turnover test and the compliance test. Registration Card holders are required to be paid by contractors after a deduction on account of tax and Class 4 NICs. Certificate holders are paid in full.
3. Contractors must make an 18% deduction on account of tax and Class 4 NICs from the payments made to Registration Card holders. This is a fixed deduction and is, in law, a payment on account of tax.
4. The rate was set at 18% because this broadly matches the average tax and Class 4 NICs liability of *individuals* and *partners* who hold Registration Cards. Present indications are that this remains about right for the majority of individuals. But it can amount to an over-deduction for *companies* who hold Registration Cards because their corporation tax liability is, in most cases, much lower.

Purpose and intended effect of new measure

5. At present, when a company comes to submit its Corporation Tax Self Assessment Return after the end of its accounting period it must set the deductions made against its corporation tax liability. In many cases, the deductions are more than sufficient to cover the whole of the company's corporation tax liability and the company will be due a repayment of the excess CIS deductions. Companies have complained that this is affecting their in-year cash flow.
6. This new measure, announced in Pre-Budget Report 2001, is being introduced from 6th April 2002 to help companies by allowing them to set off the CIS deductions they have suffered against the PAYE, NICs, student loan repayments (SLR) and CIS they are due to account for in respect of their own employees and subcontractors. In future companies will only pay over the PAYE, NICs, SLR, and CIS due after setting off the CIS deductions suffered. Any deductions that cannot be set against the payments that the company is liable to make during the

year will be repaid at the end of the tax year through the normal end of year PAYE process.

7. This measure will increase the relative competitiveness between the companies that receive net payments and the companies that receive their payments gross. Companies will no longer be able to set deductions suffered against their corporation tax liability, but we have not identified any companies that will be disadvantaged by this measure.

Benefits

8. There are a number of benefits associated with this measure:
 - The cash flow problems for most companies receiving payments under deduction will be eased.
 - Those companies on the fringes of the scheme who cannot qualify for a gross payment certificate because they have insufficient construction turnover will be able to set the CIS deduction against other liabilities. This should enable them to comply more easily with the scheme.
 - The Inland Revenue estimates that the change will benefit around 20,000, predominately small, companies paid net of deductions by enabling them to offset around £95 million against the PAYE, NICs, SLR and CIS liabilities deducted from their own employees and subcontractors in 2002-2003. Future years will see offsets of a similar size depending on the economic health of the construction Industry. The beneficial cash flow effects for these companies would enable them to grow in the same way as those with certificates by enabling them to:
 - (a) Make returns on additional investments in financial instruments.
 - (b) Have less debt than would otherwise be the case.
 - (c) Invest in capital equipment or staff earlier than otherwise would have been the case. The difference to the companies affected would be the financial difference made by any higher levels of productivity arising from earlier investment in such capital equipment or labour.

Risks

9. This measure addresses the risk that, without it, some companies with Registration Cards are less liquid and so find it more difficult to grow.
10. The main risk we have identified with this measure is that we will have to make some straightforward changes to the PAYE end of year procedures. We have kept the P35 (end of year form) as clear as

possible. The Inland Revenue's Business Support Team and helplines will offer advice where necessary.

Securing Compliance

11. The regulations will introduce a requirement to keep records of the amount of CIS set-off, on a monthly or quarterly basis, against PAYE, NICs, SLR and CIS liabilities. This will allow us to check, usually during employer compliance reviews, that the right amount has been set-off. This requirement will not, in practice, be new to companies who are already obliged to keep records and vouchers to support their corporation tax self-assessment. The new requirement will do no more than ensure that the current compliance obligations on companies are not watered down.

Compliance costs to Industry

12. There will be two main types of compliance costs arising from the introduction of this measure: Non-recurring and recurring compliance costs.
13. Non-recurring compliance costs relate to one-off, first year, costs associated with the introduction of the measure. They will include:
 - Time spent understanding the details of the change. These costs will be incurred by company subcontractors without certificates who could benefit from the measure and also agents who they may employ to do their tax returns for them. This will include time and resources spent providing existing employees with training about the changes. The Inland Revenue's Business Support Team will be able to guide the people in this group towards a greater understanding of this measure.
 - Costs associated with changing IT and other administrative systems to incorporate the effects of the change.
14. Recurring costs will occur every year and include:
 - Keeping records of amounts set off each month against PAYE, NICs, SLR and CIS liabilities deducted from their own employees and subcontractors but these will be no more than they currently need to complete their corporation tax return self-assessment.
 - Completing two extra boxes on the end of year P35 tax return instead of the one box on the Corporation tax self-assessment return.
15. We have released guidance on this measure and further guidance will accompany the end of year P35 tax return. This guidance will ensure that the changes are fully understood by those. For this reason,

it is estimated by the Inland Revenue that both total non-recurring costs (year one) and total annual recurring costs (ongoing) will be kept to a minimum.

Costs to Exchequer

16. The new measure will have no direct impact on companies' total tax liabilities. The policy costs arise from the fact that a certain amount - equal to the subcontractor deductions that companies offset against PAYE, NICs, SLR and CIS - will be received by the Exchequer in a later tax year, as part of their Corporation Tax payment. The long run costs are negligible because the movements of receipts between tax years counter-balance one another.

Impact on Small Business

17. The measures will particularly help small sized companies in the construction industry and those caught on the fringes of the scheme will be helped by this measure. Around 20,000 SMEs will be helped by this measure. It is particularly helpful to small businesses that are not eligible for a CIS certificate due to the requirements of the turnover test. This will mean that SMEs will be able to compete on a more level playing field with larger CIS certificate holding companies. The Small Business Service is content that the measure is beneficial to small businesses.

Impact of this measure on competition

18. This measure will increase the relative competitiveness between the companies that receive payments through the CIS net of deductions and the companies that receive their payments gross. It should therefore help to stimulate competition within the construction sector in the UK. This will benefit consumers of construction work.
19. Newly established companies that can't initially qualify for certificates because of the requirements of the compliance test and/or the turnover test will be among the beneficiaries. This should help to reduce barriers to entry to the construction industry and so help to increase the level of competition within the construction sector.

Consultation

20. We consulted on this issue in 2000 with the Inland Revenue/construction industry joint working group. We have also received considerable correspondence on this problem and this measure was suggested by many who wrote into us.

Monitoring and Evaluation

21. The Inland Revenue will monitor the flow of correspondence on this issue during the first two years to ascertain how effective this new measure is in helping the cash flow of companies with Registration Cards.

Contact Point

Luke Liddiard
Personal Tax (CIS team)
Room 67
Somerset House New Wing
Strand
London
WC2R 1LB
Luke.Liddiard@ir.gsi.gov.uk
0207 438 8435

REGULATORY IMPACT ASSESSMENT CONSTRUCTION INDUSTRY SCHEME

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read 'Dawn Primarolo', written in a cursive style.

Dawn Primarolo
Paymaster General

Date: 15 April 2002