

REGULATORY IMPACT ASSESSMENT

**Construction Industry Scheme: Issue of CIS5(Partner)  
Certificates**

**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:

.....

DAWN PRIMAROLO  
PAYMASTER GENERAL

.....APRIL 2001

## **Regulatory Impact assessment**

### **The Construction Industry Scheme: Extension of CIS5 cards to Partners in a firm**

#### **Introduction and background**

The Construction Industry Scheme is an administrative scheme that applies to those 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 National Insurance.

It does this by ensuring that all those who work in the industry are registered with the tax office. The subcontractors are then split into two groups: those who are paid after the contractor makes a deduction on account of tax and National Insurance Contributions and those who are paid gross.

It provides for the deduction on account of tax from subcontractors whose businesses' turnover is less than a statutory amount or who have not complied in full with all their responsibilities under the Taxes Acts. Those who have a minimum turnover of £30,000 and also pass the business and compliance tests can be paid gross. To satisfy the compliance tests both the business, and the person to whom the certificate will be issued, must have complied with all their obligations under the Taxes Acts over the period of the application. Vouchers are sent to the Revenue which document the payments made for any particular subcontractor/contractor relationship. These are used as compliance tools to check that the correct amounts are declared as income or expenditure as appropriate.

The new scheme was introduced on 1<sup>st</sup> August 1999 and built on the previous scheme that had been in existence since 1971. The legislation for the new scheme received cross-party support when it came before Parliament in 1995 and 1996 and followed close consultation with representative bodies from the construction industry. The legislation imposed few extra obligations on the industry. A compliance cost assessment was completed with the help of the industry and extra costs were estimated at that time to be in the region of £1 million across the industry as a whole. These costs reflected the limited legislative changes that had been made to the key elements of the scheme.

However, following the launch of the scheme, it became clear to both the Revenue and the Industry that the consultation in 1995 had not exposed that overall compliance with the old scheme had been very poor. Practices that had built up over the years had kept the costs of compliance artificially low in two key areas: The costs of travelling to present certificates in person, and the completion of vouchers. Consequently Ministers decided that further consultation should be undertaken in order to establish more accurate compliance costs.

Consultation with the Industry and across Government over the period from September 1999 and October 2000 identified that the way to substantially reduce the overall costs of administering the scheme, was to provide for the

electronic exchange of data. Ministers announced in November 2000 that this would be the way forward and that the Revenue would be consulting on a new Electronic Scheme with as broad a cross section of the Industry as possible. It also announced that some measures could be introduced early which would allow more information to be exchanged electronically without compromising the principals of the scheme or any way forward for the future.

The first measure was to reduce the qualifying turnover test for CIS5s for companies to £1 million (from £3million) from November 2000 and to allow partners to apply for CIS5s from April 2001 (where the partnership meets the same criteria as companies). No change to regulations was required for the first measure.

### Purpose and Intended Effect

These regulations relate only to those subcontractors who have been able to qualify for a certificate. They will have passed a business test, a statutory turnover test, and compliance tests. The normal certificate bears a photograph of the user and must be presented in person to the contractor. This personal presentation helps to ensure that the contractor pays the correct person avoiding the possibility that a subcontractor claims to have a certificate when he does not.

There is however another type of certificate that has previously only been available to companies. This certificate does not have a photograph and need not be presented in person. Instead the company is able to send a certifying document to the contractor in order to receive payment. The vouchers (CIS24s) that are completed in these cases are also solely completed by the contractor, which means that they are capable of electronic submission.

**The purpose of these regulations** is to extend the second type of certificate to individuals who are partners. This will mean that those who qualify will no longer have to travel in person and also the contractors will be able to complete vouchers and send them to the revenue electronically if they wish.

### Risks

Consultations with the industry identified that businesses had the most difficulties complying with the travelling and voucher procedures for CIS6 holders. Contractors were trying to operate the voucher rules properly but the numbers being generated by those businesses with the most contracts was putting the pressure on their ability to process vouchers generally. Contractors felt that reducing the numbers of vouchers and being able to send them to the Revenue in an electronic format would make it easier for them to comply with the scheme as a whole.

In the longer term, a fundamental shift to an electronic exchange of information will be the answer. But, in the meantime, allowing those partnerships that generate the most payments/contracts to qualify for the new type of certificate will not only reduce travelling time but also reduce voucher costs across the industry without significantly increasing compliance risks.

### Benefits

These regulations are being introduced now to benefit those businesses that are partnerships and to allow them to qualify, on the same basis as companies can, for a certificate that need not be presented in person.

One partner per partnership will qualify and this will reduce the need for multiple partners in any firm to make applications.

The Inland Revenue estimates that partners in up to 4,500 partnerships (approximately 23% of those currently using certificates) will qualify for a CIS5 and around one third of those will qualify on turnover. Those partnerships who do not apply now but whose turnover exceeds the limits will be automatically given the new certificate when they are renewed.

The partners who will apply and qualify will be those partnerships who spend the longest time travelling to show their certificates or who have the largest numbers of payments made to them in a year. To qualify the partners in the partnership must spend at least 200 hours over three years or 100 hours in *any* of the last three OR submit a high volume of vouchers (around 300 a year) to their contractors. Exceptionally partnerships will qualify if they can show a commercial need for the certificate.

### Costs

There is no statutory requirement for any partner to apply for a new certificate. It is unlikely therefore that, taking all costs and considerations into account, that any partnership will apply for this certificate unless it is of overall benefit to them, either immediately or over the life of the certificate. (Certificates are normally valid for three years).

### Costs/Savings to business

#### *Subcontractors*

Where a CIS5 certificate is granted as part of a renewal process the additional costs will be minimal and restricted to those cases where a business case is required. For partnerships with turnover of more than £1 million, qualification will be automatic (assuming a certificate is granted).

Costs borne by a partner/partnership with a turnover in excess of £1 million where the partner applies to have a current certificate exchanged for a CIS5 will vary. They will be from £150 to £540 if the partnership accountant

completes the application, and will be less if the partner himself completes the application.

Where the partnership has a turnover of less than £1 million a 'business case' will need to be submitted with the application. A business case will record particular information demonstrating that an applicant's need for a CIS5(Partner) is appropriate. Costs for completion of a business case vary, again depending on whether it is done by the applicant or their accountant but can be as little as £150 and as much as £2750 for foreign partnerships. There is no requirement that it is completed by an accountant although most businesses of this size do engage professional help.

Partners who have obtained a certificate will be able to use the alternative verification procedure. This replaces the need to travel to present the certificate in person. After notifying the tax office that they intend to use this procedure, they certify that they hold a CIS5(Partner) certificate at the same time as raising the first invoice for the contract. They only need to do this once for each contractor whilst the certificate remains valid.

Based on previous certificate applications, the Inland Revenue expects that the majority of partnerships who make a business case will qualify by setting out the number of hours they have travelled solely for the purposes of certificate presentation. These partnerships will save at least 67 - 100 hours of partner time each per year and at least 200 hours of partner time over the lifetime of the certificate. The cost to the business of this time will vary between approximately £4 per hour and £50 an hour. The Inland Revenue also estimates that each partnership will save at least £400 a year on direct travelling costs - £1200 over the lifetime of the certificates.

The Inland Revenue estimates that the average saving per partnership to be in the region of £1500 over the lifetime of the certificate, with a total saving of around £2 million.

These subcontractors will also save on administration costs in completing CIS24 vouchers.

### *Contractors*

Where a contractor pays a business that has a CIS5 certificate they complete a different type of voucher that is sent directly (electronically if they so wish) to the Inland Revenue. The exact savings will be dependent on the current practices that contractors employ for obtaining and checking vouchers from subcontractors, but the Inland Revenue estimates that the proportion of CIS 24 vouchers might be reduced by as much as 7.5%. CIS24 vouchers will be replaced by CIS23 vouchers so not all savings will be realised. But many contractors ask for one CIS24 voucher per payment and will now be able to complete one CIS23 voucher per month for those partnerships who previously sent them the most vouchers.

A survey commissioned by the Inland Revenue and carried out by KPMG and MORI provided information about the costs of processing vouchers when the scheme was first introduced. With the bedding in of the scheme and changes introduced to simplify the voucher procedures in April 2000, the Inland Revenue believes that these costs will have reduced. However they do expect that those partnerships that will qualify will have been submitting on average 100 vouchers a year to their contractors. On this basis even if half the estimated number of eligible partnerships take up the new certificate, the Inland Revenue believes that contractors will collectively save over £1 million.

### Costs to Revenue

The costs of changes to IT to facilitate the issue of the certificate and the cards themselves have been £7300. Maintenance of the system will be absorbed into current running costs.

Where certificates are issued as part of the normal renewal process, administration costs to the Revenue of issuing the certificate will be the same as a CIS6. For renewals, there will be no extra costs above those currently provided for.

It will cost approximately £20 each for the Inland Revenue to process a business case.

Implementation costs, including publicising the changes through mail shots to contractors and subcontractors, were approximately £46,000 and providing explanatory material in booklet form was £3000.

### Summary of costs/savings

Overall therefore the changes will cost the Revenue a maximum of £160,000 in the first year.

Savings to individual partnerships are likely to be up to £1500 over the lifetime of the certificate, with an estimated total saving to businesses of approximately £2 million

Savings to Contractors are estimated to be about £1 million per year.

Actual savings will be dependent on take up but approximately one third of savings will be realised from 2002 when those partnerships that have a turnover of over £1 million will qualify automatically – the Inland Revenue estimates that this will be over £1 million a year across the industry.

### Impact on Small Business

Although the turnover test is now set at £1 million, this is simply the figure over which a business will qualify automatically. Below this figure a business will qualify if it can show it can submit a satisfactory business case.

A small number of representations have been made to extend these certificate arrangements to individuals who are not partners in a firm. The numbers who we believe would qualify would be negligible and so relative cost benefits would be small. Additionally the IT changes required would have been substantially greater than those required for partnerships. Sole traders who become partnerships will be able to qualify for the certificates. And restricting issue to partnerships and companies means that they are less capable of being used fraudulently. For these reasons there is no justifiable case for extending the issue of these certificates further.

### Compliance Obligations

Only those compliance obligations that currently apply to the payments made to companies with CIS5 certificates will apply to partners with CIS5s. These are already provided for and no additional measures will be introduced. As mentioned above taking all costs and considerations into account, it is extremely unlikely that any partnership will apply for this certificate unless it is of overall benefit to them.

### Consultation

Consultation with industry and other Government Departments from April to October 2000 aimed to identify ways to improve the scheme whilst continuing to protect the flow of revenue to the Exchequer. It established that electronic business was the way to reduce substantially the administration costs of the scheme. The Government believes that, in the longer term, big savings can be achieved through a more fundamental shift to electronic data exchange, and will continue to consult with the construction industry on the precise steps required to achieve that shift. In the meantime, these Regulations provide for the first steps to enable more vouchers to be processed electronically.

### Publicity

To ensure that all contractors were aware of the changes that would be taking place the Inland Revenue sent a letter to all known contractors in the first week of January 2000. This letter was worked up in consultation with the help of industry representatives with hands on experience of the scheme. Information was also published on the website at that time. A letter was sent to all subcontractors who are partnerships holding CIS6 certificates in early April to tell them about the application procedures.

### Monitoring and Evaluation

The Inland Revenue will be monitoring take-up of the new certificate and also the flow of vouchers through the system in order to establish the beneficial effects of the changes. However, they are unlikely to be able to make any proper evaluation before April 2003.

