

Reflecting on the CIS: Three Month Review

August 6, 2024

Since 6 April 2024, most payments made by landlords and tenants are outside of the scope of the Construction Industry Scheme (CIS). New CIS regulations were introduced with the aim of streamlining the UK tax framework in relation to payments made by landlords for certain construction works carried out by tenants. Three months on from the introduction of the new regulations, we have provided our review and analysis below as to what the regulations entail, as well as the impact we expect the regulations to have on commercial landlord and tenant relationships in the future.

What is the CIS?

The CIS operates as a tax deduction mechanism framework, applying to payments under construction contracts made by contractors to subcontractors, and by subcontractors to sub-subcontractors, and so on down the construction chain. The regime was introduced to counter tax evasion from cash-in-hand jobs in the construction industry.

The CIS covers payments in respect to most types of construction work on permanent or temporary buildings or structures, or on civil engineering works such as roads and bridges, e.g.:

- demolition and dismantling;
- building work; and
- alterations, repairs and decorating.

Some exceptions are:

- professional services of architects and surveyors;
- scaffolding hire (with no labour); and
- carpet fitting.

The contractor under a construction contract must register under the CIS with HM Revenue & Customs (HMRC) if broadly, (1) they carry on a business that includes construction services and they pay subcontractors for construction work, or (2) their business does not include construction work, but they have spent more than £3 million on construction work in the 12 months since they made their first payment. These registered contractors are required to withhold a certain amount from the payments they make to their subcontractors and remit the withheld amounts directly to HMRC, unless the subcontractors are registered as gross payment subcontractors. This withholding is 20 percent or 30 percent of the payment.

Subcontractors do not have to register under the CIS. However, if they do not register, the contractor will have to make deductions at the higher rate of 30 percent from payments made to the subcontractor, as opposed to the 20 percent rate if the subcontractor is CIS registered.

The contractor then pays the amounts deducted to HMRC as an advance payment towards the subcontractor's tax and National Insurance contributions. However, if the subcontractor holds "gross payment status", the contractor can make the payment without any withholding.

Why did the government make the April changes?

Before the introduction of the new regulations, only “reverse premium” payments by a landlord to a tenant to induce the party to take the lease were outside the scope of the CIS.

This led to difficulties for commercial landlords when making contributions to tenants for works. If the landlord derived a benefit, e.g., if the tenant did Cat A works, the contribution payment would fall outside the reverse premium exemption and so be within the scope of the CIS if the landlord was a contractor for CIS purposes. In these cases, the landlord would have to withhold from the contribution and pay it to HMRC, leading to cash flow problems for the tenant unless it was registered as a gross payment subcontractor (which was not always possible in the timeframe or if the tenant was a new entity without a track record with HMRC as a reliable taxpayer), creating an administrative burden for both parties.

In response to these issues, the government carried out a consultation seeking feedback from stakeholders such as landlords, tenants and tax specialists. The majority of respondents argued that all payments between landlords and tenants should be removed from the scope of the CIS. Their rationale was that this would simplify the administrative and compliance burden that was created through the reporting and deduction procedures. However, the government decided only to widen the exemption to cover certain payments rather than give a blanket exemption for payments between landlord and tenant, out of concern that the removal of all payments from the scheme could be exploited and result in tax evasion.

New rules under Income Tax (Construction Industry Scheme) (Amendment) Regulations 2024.

From 6 April 2024, a payment from a landlord to a tenant to complete construction work on the property occupied by the tenant will not constitute a “contract payment,” and will therefore fall outside the scope of the CIS in the following circumstances:

1. the payment is for construction operations agreed upon in connection with a lease or an enforceable agreement for lease;
2. the tenant that occupies or will occupy the property will carry out the works obligations itself, or a third party will carry them out pursuant to a contract with the tenant; and
3. the payment relates to construction operations intended primarily for the benefit and use of the tenant that occupies or will occupy the property under the lease.

Impact of the new regime

These changes will be welcomed by commercial landlords, as the circumstances in which the landlord will not have to deduct tax when paying the tenant to carry out construction operations on their behalf is considerably wider, thus alleviating the administrative and compliance burden on landlords. However, landlords should not assume that all payments will fall within the new exemption – they should still assess on a case-by-case basis to ensure that all the conditions listed above are satisfied.

It is unclear as to how construction operations will be assessed to be intended “primarily for the benefit and use of the tenant”. It could be argued that if the landlord is willing to contribute to the cost of tenant works, this could imply that there is a benefit for the landlord. So, is it primarily for the benefit of the tenant? This is especially the case if the tenant does not have a reinstatement obligation at the end of the term of the lease, as the landlord would be able to enjoy the benefit of the tenant’s work going forward. HMRC has yet to provide detailed guidance on this.

This new regime will also benefit tenants, as they should now be able to receive full payment when carrying out landlords’ works without the administrative burden of having to register under the CIS and obtain gross payment status. For international businesses opening UK offices, the new regime should also relieve the friction caused by the difficulty of obtaining gross payment status as a new UK taxpayer.

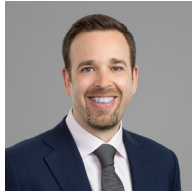
Whilst these changes are undoubtedly helpful, we would recommend that landlords and tenants continue to exercise caution when making or receiving contributions or other payments. If you have any concerns, please do reach out to the Katten UK Tax or Real Estate teams for assistance.

CONTACTS

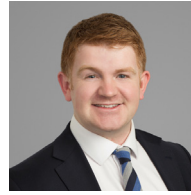
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