



Construction Industry Scheme (Current) – Compliance Test

A number of ECA members have had their applications for the renewal of gross payment certificates revoked by HMRC due to failing the Compliance Test.

This test is applied under the current scheme, every three years, following the application for a new gross payment certificate and requires the contractor to have a 'clean' tax payer history over the previous three years.

Loss of gross payment status requires deduction at source at 18% of payments made, placing an obvious burden on businesses.

Gross payment status is often a 'licence to work' as many clients will not contract with businesses who are subject to deduction.

ECA Director, David Pollock, has written to John Healey, MP, Financial Secretary, explaining the burden that net payment imposes on contractors and requesting the implementation of a warning system and a concessionary period before loss of gross payment.

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The correspondence between the ECA Director and John Healey MP, the Financial Secretary follows here.

Mr John Healey, MP
Financial Secretary,
HM Treasury,
1 Horse Guards Road,
London
SW1A 2HQ

9 March 2006

Dear Minister,

Construction Industry Scheme

The Electrical Contractors' Association (ECA) has over 2700 members which are mostly contracting companies carrying out over 80% of the total industry turnover for electrical work in the UK. These companies operate in the procurement chain as main contractors and sub contractors and in some cases both roles. Approximately 80% of companies are SMEs.

I am concerned that ECA members, who are established electrical contractors, are being denied gross payment status under the rules of the Construction Industry Scheme (CIS) due to late payment to HMRC of tax collected under the PAYE and CIS schemes.

Whereas ECA members are required to comply with the standards set by our Conditions of Membership and the Association supports and promotes compliance with statutory requirements, a number of our members have failed the 'Compliance Test' applied at the end of the three year qualifying period, due to the late payment to HMRC of tax collected.

This type of default has generally arisen due to them making payments at a month end as is business practice, thereby exceeding the date for payment set by HMRC mid month.

Contractors tend to pay all outstanding monies including their tax obligations at the later date. This practice of untimely payment is allowed to run for diverse periods of time until the end of the 3 year qualifying period, unchecked by HMRC. At this stage a contractor may have a poor payment record, with as many as 36 defaults, whilst all his tax payment obligations have in fact been met.

Failure of the compliance test automatically results in a refusal by the Tax Inspector to renew registration for Gross Payment. The operation of a contracting organisation is seriously affected by deduction of 18% from payment receipts.

- The majority of members affected are SMEs whose restricted cashflow, under the circumstances, results in the need to make major changes to the business often resulting in downsizing and even insolvency.
- Gross payment status is often a 'licence to work' as many Main Contractors and Clients will not do business with contractors who are required to be paid under deduction due to the administrative burden this imposes.
- The loss of gross payment status immediately imposes monthly payment of the tax at the provisional rate of 18% whereas the contractor would be geared to the previous tax position of more accurate payments and on a 6 monthly basis.

ECA members are by virtue of their membership of the Association established contractors subject to a Code of Fair Trading, periodic inspections of business and standards of workmanship and who, in the main, in fact pay their taxes.

In cases where non-compliance is due to late payment, I request that consideration be given to serving a notice on contractors warning them of their non-compliance and offering a trial period of, say, 3 months during which they must rectify the compliance issues. If they do not comply after this concessionary trial period, only then would they lose gross payment status.

I look forward to hearing from you.

Yours faithfully,

David Pollock
Director

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Text of reply received by the Director from John Healey MP, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

30 March 2006

"Dear Mr. Pollock,

Thank you for your letter of 9 March about problems your members have been experiencing with the Construction Industry Scheme (CIS).

The basic position under the CIS is that all subcontractors have an amount deducted from payments they receive from contractors, these sums are to be held on account of the subcontractor's final tax liabilities. If subcontractors can satisfy the qualifying criteria, the compliance, turnover and business tests, they can be granted a tax certificate and no deductions are made. However, in granting a certificate HM Revenue & Customs (HMRC) is placing the business in a position of trust and there will be an expectation that all obligations will be met in full and on time. The need for timely compliance was specifically introduced into the legislation to counter businesses simply bringing their taxation affairs up to date just before application was made for gross payment status.

HMRC provides a range of guidance to help those working in construction to understand their obligations under the CIS, for example:

- Dedicated helplines for contractors and subcontractors;
- A range of booklets and leaflets;
- An internet site; and
- Experienced staff at HMRC enquiry centres.

In particular, guidance notes are provided with application forms for gross payment certificates, both at the initial and the re-application stages. These state that the applicant must be up to date with their affairs at the time of application and must have kept their affairs up to date for the last 3 years including paying tax due on time. If this clear advice is being ignored then I am not sure that any further warnings are any more likely to be heeded.

The only function of the cards and certificates used with the CIS is to determine whether deductions should be made. If contractors choose to use them as the basis for other commercial decisions then this is something over which the Government has no control. When the new scheme comes into effect in April 2007 cards and certificates will be removed. Contractors will not be able to use the new verification service, which informs payment status, until a contract has been awarded or a tender agreed. In addition, under the new scheme, gross payment status will be reviewed more often than is currently the case, so contractors will have no certainty that subcontractors will retain gross payment status for the duration of a contract. This should go some way towards resolving the difficulties being experienced by your members.

I hope you will find this helpful.

John Healey MP