The CIS Policy Team
HM Revenue and Customs
14 Westfield Avenue
Stratford
E20 1HZ

Response by email to cisconsultations@hmrc.gov.uk

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Response to HMRC Consultation: Construction Industry Scheme reform

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to respond to the HM Customs and Revenue's consultation on reforms to the Construction Industry Scheme (CIS).

We are fully supportive of the aim to reduce abuse of the CIS by strengthening the Gross Payment Status (GPS) tests. We agree that the opportunity for fraud within the construction industry should be reduced wherever possible.

Our responses, below, to the questions within the consultation focus on the administrative burdens of landlord/tenant payments and multiple reporting requirements which have a significant effect on our members and their tenants.

Further engagement

If you would like to engage with us further regarding any aspect of our response, please contact either myself (prichards@aref.org.uk) or Jacqui Bungay (jbungay@aref.org.uk), Policy Secretariat, AREF. In addition, members of our Tax Committee are always willing to assist HMRC by sharing their wealth of knowledge and expertise in respect of real estate funds.

Yours sincerely

Paul Richards

Managing Director, The Association of Real Estate Funds

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has over 50 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the MSCI/AREF UK Quarterly Property Funds Index and the AREF Property Fund Vision Handbook.

Responses to questions

Strengthening the GPS tests

Q1: What are the views on including VAT in the GPS compliance test?

We are supportive of targeted measures to combat fraud and tax evasion. It is important that the measures do not disproportionately impact contractors or subcontractors either in imposing significant additional administration or penalising minor breaches of the VAT regime that are quickly rectified. Additionally, it is important that subcontractors that are in VAT groups are not disadvantaged where a compliance failure relates to a wholly unrelated business elsewhere in the VAT group. This is potentially particularly relevant in the context of complex groups involved in fund management where activities within the group may be wholly operationally separate from one another.

Q2: Can you see any unintended consequences if VAT was added to the compliance test: are there barriers to submitting returns/payments in a timely manner, and could the proposal affect compliant or particular sized businesses?

We note that VAT is operating under a new points-based compliance regime and it may be too early to tell whether this itself will create issues for taxpayers which might affect the GPS compliance test.**Q3: What channels of application are preferred, and do you envisage any challenges in shifting to digital?**

In relation to digital applications, we can foresee authorisation being a factor in holding up applications, whereby HMRC reject due to the incorrect person making the registration. We suggest either an upload of an authorisation letter (like what is provided to HMRC when making an option to tax) or a tick box that the director is happy for the form to be submitted.

The digital application forms need to be sufficiently flexible to accommodate businesses which are not UK companies. In particular they need to be able to be used by partnerships (established both UK and overseas) as well as other types of property holding vehicles such as Jersey or Guernsey Property Unit Trusts.

A 64-8 form specifically for the CIS needs to also be available so that tax agents/in-house tax teams can contact HMRC about a registration. We recommend that the HMRC phone line is kept in use for a period when shifting to digital.

See also our further comments in Q12 relating to application processes.

Q4: Are there any other changes that could be made to the scheme which would prevent abuse, while also maintaining simplicity for legitimate users?

We have no suggestions for changes to the scheme which would prevent abuse.

Simplifying the treatment of payments made by landlords to tenants

Q5: Should any landlord to tenant payment be within the scope of CIS?

We believe that all landlord/tenant payments should be outside the scope of CIS. This would bring it in line with the domestic reverse charge for VAT.

Some of our fund members or property holding vehicles are registered as “deemed contractors” despite the fact that neither they nor the tenants to which they are making inducement payments are involved in the construction industry. When they make payments to tenants for work, which would normally be their responsibility, these are considered to be within the scope of CIS. If the quantum of such payments is above the specified threshold, then our members are required to register as a contractor and apply the CIS to contributions to tenants for works. Our members find analysing contributions and including part or all of them in the monthly CIS returns adds to their administration costs.

Payments from a landlord to tenant for works, although technically caught within the current rules, are not in our view the intended target of the scheme. This issue can create delays in granting leases, as tenants, not always being within the construction industry, are often unfamiliar with the CIS and not registered with gross payment status. Time and money are spent on negotiating how to document the landlord to tenant payment and whether the tenant will register as a sub-contractor in advance of the contribution. This delay and confusion can be exacerbated where there is ambiguity over the potential use of the funds by the tenant, i.e. whether it actually falls within the CIS or not. Depending on the sophistication of the tenant this can result in lengthy discussion as well as relatively significant

advisory costs being incurred. The extensive delays that are being experienced in getting CIS registrations, of all kinds, has led to material cashflow problems for some tenants, because it is not possible for the landlord to make a payment until the landlord has registered as a deemed contractor, the tenant has registered as a subcontractor, HMRC has processed both applications, and the landlord has verified the CIS status of the tenant.

Further, it is often the case that a tenant is neither an employer (typically because they are a company within a larger group) nor a contractor or deemed contractor, and is not eligible for GPS (due to having no history of construction turnover) and therefore suffers and is not able to recover CIS deductions from a landlord contribution until filing their corporation tax returns many months after the payment, while they are typically obliged to pay a subcontractor the full amount of the landlord contribution to carry out the works.

Difficulties also arise in determining whether/when a fund entity has become a deemed contractor. Often an entity will make contributions of varying nature and quantum to a tenant/tenant(s). The complexity of the analysis required and the fact that a landlord payment could be technically caught under the current CIS rules adds to the management time and costs burdens in the process. Our fund members want to ensure compliance with CIS and disclose issues such as late deemed contractor registration. However, such disclosures are a costly exercise and take a significant amount of time, including lengthy analysis of historic landlord/tenant contributions. There are extensive delays in responses to disclosures, which leaves funds in an uncertain position with regard to historic CIS status and potential penalties/interest. This can impact negatively on sales processes. Removing landlord/tenant contributions from the scope of CIS should prevent these issues in future.

Q6: Do all landlord to tenant payments include an inducement or encouragement element?

Landlords to tenant payments form an intrinsic part of a lease agreement. The reasons for such payments vary but clearly are part of an overall lease contract negotiation and therefore, it could be considered that the complete package of lease terms collectively, help to induce the tenant to agree the lease terms. It is not necessarily the case that each element in isolation is an inducement.

Q7: How do you identify whether a transaction includes an inducement or encouragement element?

Typically, our members have internal discussions to ascertain the commercial rationale for a landlord to tenant payment and the extent to which it is an inducement. i.e. is this a new or existing tenant, what are the other terms of the lease, is the contribution a pure inducement or specifically for the purpose of doing works, what works will take place and for whose benefit will the works be, on a rent review or at the end of the lease term what is happening to the works that were carried out. When the commercial position has been ascertained, there will be discussions with external legal and tax advisors to confirm any inducement element and to document this appropriately in the agreement for lease/lease/contribution agreement.

Q8: What are the drivers for delegating building fabric works to tenants rather than landlords arranging it themselves?

Often a tenant will have specific requirements as to the specification of the building they require. In such a case it may make sense for the tenant to procure the relevant works. Given the co-dependencies of commissioning construction work it is frequently the case that the tenant may procure works that otherwise the landlord would undertake in order that the works can be completed efficiently from an operational perspective.

Q9: Which of the solutions suggested is preferable?

Our members would prefer a clear, simple solution, which removes the need to analyse the nature of the contribution and the underlying works. Therefore, the following options would be preferable:

- widen scope of Regulation 20 to treat all landlord tenant contributions as reverse premiums;
- amend Section 61 Finance Act 2004 – Deductions on account of tax from contract payment – so as to treat landlord to tenants payments as not being ‘contract payments.

Our members consider that solutions that use or rely on the definitions of CAT A and CAT B works, and/or rely on the intention behind the payment, risk becoming complicated and confusing to apply. The intention behind a payment is not always singular and clear, and the CAT A/CAT B distinction can also be difficult to apply. The CAT A / CAT B

distinction is also a dynamic concept in the sense that the nature of market standards evolve over time and thus what was historically considered firmly to be a landlord responsibility versus tenant may change.

Solutions that automatically give gross payment status to tenants could potentially work well for landlords, but it is not clear whether this would undermine the purpose of gross payment status, for example, if a tenant is given the status automatically when their tax affairs would not typically allow for gross payment status to be granted. Further, if there were any delays in HMRC providing evidence of a tenant's gross payment status, this would continue to cause delays in lease grant and potential cashflow issues.

Q10: What are the advantages and disadvantages of these proposed solutions?

Our members consider that treating all landlord to tenant contributions as reverse premiums, which are outside scope of CIS, and/or treating all such payments as not being "contract payments", are the simplest solutions of the options proposed in the consultation. The advantage of these solutions are, as follows:

- the landlord will not need to spend time and money on analysing the reason for the contribution or categorizing the works;
- the solutions do not depend on additional paperwork or registrations; they are simple to apply;
- there is no need to educate the tenant on the CIS, which is helpful as many tenants are unfamiliar with the scheme and when it could apply to them.

Q11: Is there a risk of creating the potential for manipulation/avoidance of the scheme by the diversion of monies via tenants?

Our members consider that the risk of potential manipulation/avoidance of the scheme is low if landlord/tenant contributions are removed from the scope of the CIS.

Reducing the administrative impact on certain groups of operating the CIS

Q12: Are there groups, other than property groups, that are affected by the excessive volume of returns they are submitting to HMRC?

Managers of property investment funds are impacted by having to deal with an excessive number of CIS returns. They may be responsible for many hundreds of companies and other property holding vehicles, and - like property groups - relevant CIS payments are irregular and infrequent. This is complicated by the fact that such funds do not typically include contractors or subcontractors, but only deemed contractors so there is an ongoing requirement to monitor each entity in the group to determine whether the registration threshold is met.

Q13: Is a 'grouping arrangement' the best solution to the problem outlined and are there any elements which have not been set out?

The 'grouping arrangement' approach set out in the consultation wouldn't work for property funds for the following reasons:

(a) joint and several liability doesn't work within fund structures which include minority holders and finance providers who are not willing or able to take on a risk of a liability arising in respect of an associated entity.

(b) limiting it to entities with Gross Payment Status (GPS) would exclude property funds. GPS relates to the entities' position as subcontractors not as contractors. Property funds are deemed contractors that never (or extremely rarely) act as subcontractors and therefore wouldn't be able to make use of grouping.

(c) The approach refers only to companies; provision should also be made for other vehicles that hold property eg partnerships and unit trusts.

(d) A fund management company is responsible for administration of a large number of property funds that it does not have ownership of and which are not under common ownership (as the funds are managed on behalf of third party investors who are the fund management company's clients), and therefore could not be grouped.

We would welcome the ability for fund managers to file a “consolidated" return aggregating the reporting of CIS payments for entities for which they are responsible. The option to file a single monthly return aggregating all of the payments made in a month would not, by itself. provide a complete solution to the problems faced by property funds and their management companies, because the work would still need to be performed at the individual entity level, but it may reduce some of the administration. This should be an optional arrangement and not mandatory given that it may not always be possible to aggregate the information automatically (especially if different accounting systems are in use, or entities are acquired or disposed of).

A potential improvement to the CIS scheme for property funds would be a fast-track way for a fund manager (already registered with HMRC for the purpose) to add new registrations for their funds and holding entities as deemed contractors, and to begin verifying subcontractors straight away, rather than having to wait for HMRC to process the application.

Q14: What responsibility in a ‘grouping arrangement’ should rest exclusively with the individual companies within the group and what responsibility with the nominated company?

See above.

Q15: Do you see any specific anomalies which may arise in the context of CT and VAT grouping arrangements?

Property funds don’t necessarily form a group in the same way as a CT group or VAT group. As noted above, this is because property funds are usually structured with partnerships and unit trusts, so do not meet standard corporate grouping requirements.

Q16: Should the reporting of intra-group transactions be excluded on the CIS group return?

Yes, we agree that intra-group transactions should be excluded on the CIS group return. The aim of the regime is to ensure tax is collected at source where the payee might not pay the tax; plainly that policy has no application where both the payer and payee are under, broadly, the same ownership.

Q17: Will establishing a ‘grouping arrangement’ impact on third party software providers?

Some software development may be necessary to facilitate aggregation of CIS reported information. If aggregation is optional this should not create an adverse impact.

Q18: Should the process of a ‘grouping arrangement’ be statutorily prescribed by HMRC, and if so, to what extent?

No. Group treatment should not be mandatory.

In our view the most significant improvements in terms of managing large numbers of CIS registrations can be gained through administrative enhancements to facilitate registration, verification and reporting processes at an aggregate level, which do not require statutory change.

Entities within funds should remain liable individually and not jointly or severally but could be managed by a central administration team within the fund manager group.**Q19: Are there any other issues you think will need to be considered?**

Further simplification of the CIS

Q20: Are there areas of the CIS in terms of its scope and or administration where simplifications or improvements could be made?

Our members consider that a key area for improvement is to speed up the process of registrations. The current process involves waiting to receive correspondence in the post before the registration is completed. This can cause unnecessary delays, as hybrid working practices means that correspondence takes time to reach the relevant individual. Delayed registrations can also result in penalties and interest for late filing. Our members would welcome changes that would streamline the registration process, including use of technology and online systems to provide the codes required to register.

For fund managers who are responsible for a large number of CIS registered entities, it is burdensome to have no ability to verify subcontractors' registration status without logging in to the Government Gateway using each individual CIS registered entity's contractor registration login details. A better system would allow verification to be performed by a registered and properly authorised manager of a portfolio of CIS registered entities (which may or may not be part of a "group") on behalf of any of those entities.

We would propose the removal of the construction turnover test from the GPS requirements. For entities that are not active in the construction sector but are otherwise tax compliant established businesses, or new entities within an established tax compliant group, the test does not provide a good measure of the likelihood of being non-compliant. Compliance checks already provide a mechanism for HMRC to identify non-compliant businesses.