The CIS Policy Team
HM Revenue and Customs
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Response by email to cisconsultations@hmrc.gov.uk

9 January 2024

Response to HMRC Consultation: Construction Industry Scheme (CIS) proposed amendments

We, the Association of Real Estate Funds[1] (AREF), welcome the opportunity to respond to the HMRC consultation on proposed amendments to the Construction Industry Scheme (CIS) regulations.

We remain 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, but agree that sensible exceptions for minor compliance failures should not result in loss of GPS.

The CIS rules were designed to address non-compliance within the construction industry, but result in considerable administrative complexity for landlords and tenants, who were not the intended target of the regime. The proposal to remove the application of CIS from most payments from landlords to tenants is therefore welcome, however it is important that the detail of the rules do not result in further uncertainty. We believe that the draft proposals do not effectively achieve either the exclusion of most payments or the removal of uncertainty, and may indeed bring some such payments within the scope of the regime that previously would not have been.

Our response should be read alongside the more general comments provided in our letter of 20 July 2023 in response to the initial consultation[2] (CIS reform consultation).

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.

[2] Construction Industry Scheme (CIS) reform consultation published on 27 April 2023

General Comments

Minor VAT compliance failures

We welcome the fact that the regulations will include exceptions covering minor VAT failures and errors, in a way that is consistent with other taxes. We consider that the proposed amendments to Regulation 32 of SI 2005/2045 provide a reasonable balance, subject to the comments below.

Simplifying the treatment of payments made by landlords to tenants

As stated in our letter of 20 July, 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 and would be simple to apply.

We recognise that any exception has the potential for exploitation, and the summary of responses to the CIS Reform Consultation suggested that unscrupulous landlords could use artificial leases to circumvent the CIS. This would be a high-risk strategy for what is only an administrative benefit for the landlord.

We assume the idea would be that the landlord would grant a lease (at a low rent) to a construction company for the use of the land during a construction project, and seek to treat the payment for construction services as a landlord-tenant payment.

We consider that a simpler test for such artificial leases could be designed than the one proposed – for example, if the tenant is required to pay more in rental payments over the term of the lease (before the earliest opportunity for the tenant to break the lease) than the landlord is paying the tenant (invariably the case in genuine landlord tenant payments), then this would entirely negate the benefit for a construction company in agreeing to such a lease.

Review of draft regulations

Clause 2(1)

We agree that the removal of Regulation 20 is appropriate on the basis that Regulation 24ZA provides an effective replacement (however see comments below).

Clause 2(2)

Considering the clauses of the draft Regulation 24ZA in turn:

(1) We have no comments in relation to this clause.

(2) (a) – The reference to the payment being “for construction operations agreed” is not necessary and may cause perverse outcomes. For example, if the lease provides for multiple landlord payments, some of which are to pay for construction, and others which are not (such as a reverse premium or a contribution to the tenant’s legal costs relating to the lease), then (because the presence of some construction means that the entire contract is a construction contract), the condition as drafted would mean that contract payments that are not for construction would be brought back into CIS (because they would not meet the conditions for the s24ZA exclusion). We would suggest amending the wording to “the payment is made as a consequence of a lease agreement”.

(2) (b) – We assume the intention of this condition is to exclude construction that will in practice be performed by the tenant rather than via a sub-contractor. However, we do not consider that the use of a written contract is a necessary or helpful test. In particular:

(i) It imposes an additional burden on landlords to establish, and retain evidence of, the existence of such a contract, that does not currently exist under the current regulations. The nature of a written contract is not clear – would a simple quote and acceptance be sufficient? Also, tenants may be unable/unwilling to share the details of their contract with the landlord (for example if bound by a confidentiality clause);

(ii) It does not allow for the possibility that the tenant may engage more than one contractor, or the possibility that the tenant’s contractor would itself sub-contract some or all of the work;

(iii) for an unscrupulous landlord, it would seem relatively easy to manufacture a written contract in an artificial scenario which would meet the condition (i.e. the condition does not prevent abuse).

(2) (c) – See comments above regarding the use of the term "construction operations". We would suggest replacing the initial words with "where the payment is for construction operations, those construction operations…"

The limit "exclusively to parts of the property which the tenant occupies or will occupy under the lease agreement" is likely to be a cause of considerable uncertainty and means the regulation is likely to fail in its objective of excluding 'most' landlord to tenant payments.

The exclusive language means that even a small part of the payment relating to works to the exterior of the property, or common parts, would take the entire payment out of the Regulation 24ZA exclusion – including matters that might under the current rules have been considered contributions to tenant's works excluded under Regulation 20. Examples might include contributions to the cost of painting a shop front to match the tenant's branding, or the installation of specialist communication cabling through common parts to meet a tenant's specific requirements.

Much of the considerable cost and administrative time spent in dealing with CIS relate to answering questions around arbitrary lines –e.g. is the proposed works more like a 'hairdresser's equipment', a 'pagoda roof' or 'electrical floor boxes'[3]? By introducing a different defining line ('exclusively to parts the tenant occupies') the problem is not solved, but merely shifted to a different set of arbitrary tests – e.g. For works involving a wall, floor or ceiling that the tenant is on one side of but not the other – are these exclusively in or out? If the tenant is the only occupant of the building does this mean the contribution to the pagoda roof is outside the scope? Etc.

In this context, it is worth reflecting that – in genuine landlord payments under genuine leases – these are common and commercial arrangements between parties that are (in most cases) not involved in the construction industry, and far removed from the types of tax evasion that were the target of CIS in the first place. The was recognised in the implementation of the VAT domestic reverse charge for construction contracts, and this approach should be considered here too. The conditions should seek to identify artificial leases that are set up to avoid CIS rather than burden landlords and tenants under genuine leases with a tax regime of which they are not the intended target.

Clause 2(3)

In our view the proposed inserted words "*or c) tax charged by or under the Value Added Tax Act 1994(b)*" are capable of misinterpretation. They could be construed as applying to any payment of VAT, including for example the payment of VAT charged on an invoice issued by a supplier, such that late settlement of the invoice could be considered as a VAT compliance failure, which is clearly not the intended outcome.

We would propose that the wording be amended to clarify that it is intended to apply to amounts of VAT payable to HMRC. For example "*or c) payments of VAT due to HMRC following the submission of a VAT return"*

[3] See CIS14045