

Association of Accounting Technicians response to the HMRC consultation “Fraud on provision of labour in construction sector: consultation on VAT and other policy options”

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the HMRC consultation “Fraud on provision of labour in construction sector: consultation on VAT and other policy options”, published on 20 March 2017.
- 1.2. AAT is submitting this response on behalf of our membership and for the wider public benefit of achieving sound and effective administration of taxes.
- 1.3. AAT has commented in order to add value or highlight aspects on the practicalities of implementing the measures outlined that need to be considered further and focussed on the operational elements of the proposals.
- 1.4. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by AAT’s 4,250 licensed accountants.

2. Executive summary

- 2.1. **It is important that policy decisions to tackle organised fraud do not adversely affect small tradesmen who are required to register on the Construction Industry Scheme (CIS).** The CIS scheme was introduced in the 1970s to address potential non-compliance in the construction industry; an industry that traditionally attracts a large and highly mobile workforce engaged in large construction projects, which can lead to particular difficulties in securing appropriate payments of tax and national insurance contributions. Over the years the CIS scheme has been expanded to incorporate tradesmen working on small commercial or domestic construction projects who do not necessarily regard themselves as part of the large construction industry.
- 2.2. **AAT recommends that proposals for any domestic VAT reverse scheme be restricted to companies in the sectors and of the size where fraud has been identified.** Proposals should not involve the vast majority of small or micro-sized businesses not connected with this fraud.
- 2.3. **AAT supports action to combat fraud including ‘phoenix trading’** (condoc 1.6), which can often involve losses to small tradesmen.

3. AAT response to the consultation paper

Question 1: Do you think the scope of a reverse charge for construction services should exclude supplies to final customer?

- 3.1. AAT agrees that the scope of a reverse charge for construction services should exclude supplies to the final customer as this would be an added complication that is unnecessary to prevent supply chain fraud.
- 3.2. Any reverse charge should not be applied to the majority of businesses in the construction sector who meet their tax obligations in full and on time. The CIS scheme is already so

complex that it incorporates tradesmen who would not regard themselves as working in the construction industry as in the example:

*"...of a joiner whose business is to install new kitchens to household customers. The joiner may not be registered to connect the gas supply. If the customer specifically asks the gas company to connect the gas to the appliance no problem arises on CIS. On the other hand if the joiner who has undertaken the contract with the domestic customer pays the gas firm he must register under the CIS, must verify with HMRC the payment status of the subcontractor (the gas company - however large the organisation) prior to making payment and account for payments in monthly CIS returns. Many kitchen fitters who buy material and appliances as part of their overall service to household customers will have turnovers which exceed the VAT threshold."*¹

- 3.3. Also, any remedy should be targeted at the "...larger businesses at the top of supply chains where fraud has been discovered" (condoc 1.8).

Question 2: Do you think a labour/non-labour threshold for the application of the reverse charge should apply throughout the supply chain? If so, at what level should it be set?

- 3.4. A labour/non-labour threshold for the application of the reverse charge should apply throughout the supply chain. However, the threshold should be set at a very high level, given that HMRC "are consulting on key proposals for disrupting and closing down the operations of those cheating the system" and that "HMRC estimate that there could be approximately 250,000 VAT registered businesses working in construction and the vast majority will be small or micro-sized not connected with this fraud".
- 3.5. Increasing the Gross Payment Status (GPS) turnover threshold for new companies whereby they would need to show that they have entered into contracts with an aggregate value of £250,000 of which at least £75,000 has been received would make it more difficult for fraudsters to show that they are a legitimate business without impacting on companies with an established trading history. This accords with HMRC "...awareness of the larger businesses at the top of supply chains where fraud has been discovered" and in the context that HMRC "...are currently investigating cases where estimates of the revenue losses are in the tens of millions of pounds."

Question 3: Are there any implications we should consider if there is no designated main or principal contractor?

- 3.6. Occasions will arise where there is no designated main or principal contractor when certain customers directly engage several construction firms to complete particular aspects of work. These customers might include a public authority or voluntary organisation but these organisations will be obliged to comply with CIS regulations.
- 3.7. By definition there will be no supply chain and one would expect the public authority to verify the trading history and reputation of each contractor.

Question 4: Can you think of reasons why architects or engineers should not be treated as main contractors for reverse charge purposes? Are there other similar recipients of such supplies who should have the same treatment? What type of services should a reverse charge apply to?

- 3.8. Architects and engineers involved in large construction projects are highly likely to be employed by reputable firms and also be members of professional bodies with high standards that would potentially expel any members found guilty of fraud. Any actions taken by the Architects Registration Board or Institute of Civil Engineers is likely to be in addition to any civil or criminal sanctions imposed by the courts.
- 3.9. AAT recommends that the reverse charge be applied to large subcontractors/contractors who are involved at the top of large construction enterprises and at the top of supply chains.

¹ Facts based on G Laithwaite v HMRC [2014] UKFTT 0759(TC) TC03879

Question 5: What are your views on using the CIS definition as the reverse charge definition? Should there be a threshold?

- 3.10. On the basis that construction or labour provision services cover such a wide range of services it is reasonable to use the CIS definition as the reverse charge definition.
- 3.11. AAT supports a sales based threshold at the levels outlined in paragraph 3.5 above.

Question 6: Do you have any views on whether a narrower CIS definition or alternative qualifying criteria could be used to exclude small businesses instead of a sales based threshold?

- 3.12. A sales based threshold on new entrant companies would be the least complicated qualifying criteria because the current wide scope of CIS makes a narrower CIS definition difficult.
- 3.13. It is a wholly unacceptable proposition that *“As the scope of any reverse charge needs to be comprehensive to achieve the anti-fraud effect, this means potentially there will be a large number of small businesses that are not a fraud risk that will need to apply the reverse charge to their sales”* (outlined in condoc 2.20 and to which Question 6 follows). This contradicts HMRC’s stated aim at condoc 1.10 *“...to see how we might best exclude the honest majority of smaller businesses from any potential VAT change”* and unnecessarily increases the administration and cost burden upon them.

Question 7: Would setting a threshold by invoice value create uncertainty and lead to a confusing application of the reverse charge?

- 3.14. A single threshold applied to the value of the contract based on all sites or projects between the contractor and sub-contractor would be simpler than a threshold based solely on invoice value because it avoids fluctuations in invoice values and many contract values are known as they are agreed in advance.
- 3.15. While a threshold based on invoice value should not create uncertainty in short contracts the disparity between the costs of some types of services and variations in contracts resulting in fluctuations in invoice values might lead to a confusing application of the reverse charge.

Question 8: Are there contracts that do not lend themselves to the application of a threshold in this way and if so can you provide details please?

- 3.16. Complications might arise in contracts with staged payments but any such complications should be surmountable.

Question 9: If you think a threshold based on contract value would work, do you think it should be based on sales made monthly, annually or a combination?

- 3.17. Owing to the wide range in nature of CIS contracts, some flexibility in the setting of thresholds will be appropriate. AAT therefore supports the combination of thresholds suggested at condoc 2.26, that is a monthly threshold of £50,000 or an annual threshold of £250,000 as appropriate to the contract.

Question 10: If you disagree please can you explain why a reverse charge might affect self-billing or applications for payment arrangements?

- 3.18. AAT agrees that a reverse charge would not necessarily interfere with arrangements for self-billing or applications for payment arrangements as it does not change existing time of supply rules, nor the value of the supply.

Question 11: Can you see problems with requiring the reverse charge to apply to services supplied by FRS users?

- 3.19. The reverse charge should not apply to services supplied by Flat Rate Scheme (FRS) users because of the modest turnover ceiling of £225,000 and also because VAT is not reclaimable on purchases.

Question 12: If a reverse charge was to be introduced, how long would you need to make the necessary IT and billings changes after any announcement? Does having a threshold significantly alter this?

- 3.20. Contractors will need time to arrange to alter billing arrangements with their sub-contractors and to make the necessary IT changes.
- 3.21. A notice period of a month, which HMRC has applied in other industries, is insufficient. However, it is noted that HMRC's has suggested that it would work with genuine businesses that are struggling to make the changes in time. In the past HMRC has agreed light touch periods lasting up to six months. HMRC Assurance Officers should evaluate applications for extended time from businesses based on HMRC's knowledge of the history of the business.
- 3.22. Having a threshold does not significantly alter the time needed to make the necessary IT and billings changes.

Question 13: Do you agree that any changes to the CIS should be restricted to companies?

- 3.23. AAT agrees that any changes should be restricted to companies for the reason given in condoc 3.10 that "...the misuse of the CIS scheme is concentrated in the company sector" and that smaller sole traders or partnerships not involved in this type of fraud are likely to suffer disproportionately from an untargeted response.

Question 14: We are interested in views on whether changes to the turnover test should only be applied to companies that have not traded before?

- 3.24. The turnover test should only be applied to companies that have not traded before on the basis that this may disrupt new criminal entrants intent on VAT fraud.
- 3.25. AAT recognises that this would not prevent criminal gangs acquiring existing companies with GPS but supports the use of section 65 of the Finance Act 2004 to require further information to reconsider the compliance tests.

Question 15 (1st part): If the threshold was to be increased, at what level do you think it should be set in order for it to be effective against fraud whilst not excluding too many legitimate businesses?

- 3.26. AAT agrees with the thresholds set out in the consultation document (3.12) to increase the GPS turnover threshold for new companies who would need to show that they have entered into contracts with an increased aggregate value of £250,000 of which at least £75,000 has been received.

Question 15 (2nd part): Should the increased threshold apply if an applicant's controlling company already has GPS?

- 3.27. The existing threshold should continue where the controlling company already has GPS provided the company has an established compliance history.

Question 16: What are your views on requiring customers to notify HMRC of changes of ownership or control of businesses supplying labour?

- 3.28. Customers should not be required to notify HMRC of changes of ownership or control of businesses supplying labour. CIS sub-contractors have enough regulation relating to their own businesses without being required to provide information on the main contractors.

- 3.29. There may be an issue with fraudsters taking over established businesses which already have GPS. Therefore, HMRC should use section 65 of the Finance Act 2004 to require further information to reconsider the compliance tests where there is a change in control of a company which has GPS to determine whether the directors and, in the case of a close company, the beneficial share owners satisfy the compliance tests for individuals. Nevertheless, an issue may arise where HMRC become aware of the change in ownership after fraudsters have already claimed back input tax.

Question 17: Would it be feasible to define certain triggers after which contractors are required to determine whether control of subcontractors has changed? How much burden would that place on contractors?

- 3.30. It is not feasible for contractors to be required to determine whether control of subcontractors has changed. They may receive information to suggest a change in ownership but this may be rumour, or otherwise incomplete or misleading information. It is therefore unreasonable to require a contractor or subcontractor to report to HMRC such incomplete information relating to another company.

Question 18: Should a different compliance test be set for those directors or shareholders who have not been previously required to fulfil obligations under the Taxes Acts?

- 3.31. Directors and shareholders of new companies should be required to show that they have previously fulfilled all their obligations under the Taxes Acts before GPS can be given.
- 3.32. AAT does not support the introduction of more obstacles for tradesmen seeking to develop a new business but accepts the option of delaying Limited Company GPS on new companies, as this still enables a company to sub-contract - although the contractor will deduct tax.

Question 19: Are there other options that we should consider for combating this fraud?

- 3.33. An option to consider is requiring a security or bond (similar to certain PAYE requirements) where the compliance history of a company is uncertain and the VAT involved is above a certain threshold.
- 3.34. Other options are to tighten HMRC policing on VAT input tax claims by requiring monthly VAT returns for new entrants and identifying chains where directors or shareholders are connected.

Question 20: What impact are the proposed changes likely to have on your business?

- 3.35. Many SMEs and micro-entities employ AAT members or would be represented by AAT's 4,250 licensed accountants, a number of these clients being engaged in the Construction Industry. A significant proportion of those engaged in the provision of labour only will be below the VAT threshold but a general domestic reverse charge as described in condoc 2.1 would incur unwelcome complications and burdens on small traders. However, it is anticipated that the changes to the turnover test for new companies only, which is based on contract thresholds of an aggregate value of £250,000, would not impact on many clients.

Question 21: Are there any specific impacts on small and micro businesses that are not covered in this chapter and chapters 2 and 3? If so, please provide details of the anticipated one-off and on-going costs and burdens.

- 3.36. The concept of CIS operatives as a "*large highly mobile workforce*" prevalent in the 1970s (condoc 3.1) engaged in "*large construction projects*" (condoc 1.5) is far removed from the current widened scope of the CIS scheme and many contractors are not involved in "*large civil engineering projects*" where actual fraud has been identified (condoc 1.4). So a general domestic reverse charge would impose additional complexities and an unwelcome burden to the current highly regulated CIS scheme which applies to many small and micro businesses.

- 3.37. Although a domestic reverse charge would only apply where both the provider and the purchaser of the transaction in question are registered for VAT that would exclude a private household, but where the kitchen fitter in the example in Question 1 above was sub-contracted to a larger company, for example a kitchen sales company, the sub-contracting trader would be caught.
- 3.38. An example of a one-off cost would be to change invoicing procedures with the supplier company. An example of on-going costs and burdens would be the two tiers system whereby VAT would continue to be charged to household customers and VAT would still be deductible where incurred on trade costs and overheads as input tax as before but with requirements for invoices to show where the reverse charge applies. The burden on a one-man company on such a two tier system would clearly be unwelcome.

4. About AAT

- 4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Aleem Islan, AAT Technical Consultation Manager, at:

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