



TC02462

Appeal number: TC/2011/09752

INCOME TAX – construction industry scheme – deductions from payments to subcontractors – travel and other expenses included in subcontractor invoices – obligation to deduct tax from such payments – determination to recover underdeductions from the Appellant under Regulation 13 Income Tax (Construction Industry Scheme) Regulations 2005 – HMRC refusing to make a direction under Regulation 9(5) of those Regulations absolving the Appellant from liability to pay the shortfall to HMRC – whether Appellant took reasonable care to comply with section 61 Finance Act 2004 and those Regulations

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

REFIT SHOPFITTING SERVICES LIMITED

Appellant

-and-

**THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE & CUSTOMS**

Respondents

**TRIBUNAL: JUDGE KEVIN POOLE
RICHARD CORKE FCA**

Sitting in public in Bristol on 14 December 2012

**Stephen Theaker FCA CTA of UHY Peacheys, Chartered Accountants, for the
Appellant**

Gill Carwardine, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal centres on the extent of a contractor's obligation to deduct tax
5 under the construction industry scheme ("CIS") from payments it makes to subcontractors.

2. The Appellant, as a result of what HMRC accepted to be an error made in good faith, deducted less tax than it should have done under the CIS from payments it made to subcontractors. In particular, it did not deduct tax from parts of the payments
10 which were attributable to expenses (mainly, if not exclusively, travel and lodging expenses).

3. After an inspection of the Appellant's records, HMRC sought to recover the whole of the underdeducted amounts from the Appellant. They refused to make a direction under Regulation 9(5) of the Income Tax (Construction Industry Scheme) Regulations 2005 (the "CIS Regs") absolving the Appellant from responsibility for
15 paying the amounts of the underdeductions to them. The Appellant appealed against this refusal, and that appeal was ultimately notified to the Tribunal under Regulation 9(9) CIS Regs.

4. The main issue to be determined by the Tribunal was therefore whether the
20 Appellant had taken "reasonable care to comply with section 61 of [Finance Act 2004] and [the CIS Regs]".

5. The Tribunal also had to examine the extent of the Appellant's obligation to deduct, to ensure HMRC were not seeking to make it liable for amounts which were not in fact due from it under CIS.

25 The facts

6. The Appellant was incorporated in November 2005. Its Director was Jeffrey Nind, who gave evidence before us. We found him to be a reliable and forthcoming witness, who clearly adopts a responsible and careful attitude to running his business and complying with his obligations.

7. Mr Nind had worked as a self-employed carpenter himself for over 20 years, including 10 or 11 years registered as a subcontractor (subject to deduction of tax) under CIS up to about 2000. He had worked for, among others, Wimpey and Redrow for 18 months to two years in the late 1980's as a subcontractor. He had then worked for a smaller executive house building company in the same capacity for 10 or 11
35 years.

8. When he worked for Wimpey and Redrow, he generally paid his own travel expenses (he tended to work on sites that were reasonably local to him). But if he was asked to work special hours, for example on Sundays, they would pay his travel expenses and made no deduction from that element of his payments under the CIS
40 rules. If he was required by them or his later contractor to incur extra expenses (for

example hiring equipment or vehicles for them, or driving to pick up materials for them) then he would be reimbursed those expenses without deduction of tax. From his widespread knowledge of other subcontractors in the industry, that was still the practice.

5 9. In about 2000, Mr Nind took a job as a contract manager with a shopfitting company based in Cardiff. In that role he was not responsible for their CIS compliance, but his understanding from dealing with the subcontractors was that there remained a general understanding in the industry that "expenses were paid gross".

10 10. The opportunity arose in 2005 to establish his own business, and he incorporated the Appellant. Its business is nationwide, involving refitting retail shops.

15 11. When he established the business, he appointed an accountant to provide advice (the same accountant as he had used whilst self-employed). Whilst Mr Nind ran the CIS returns and payments himself, his accountant did not question any of his practices when he handed over all his documents at the end of the year for the production of his annual accounts.

20 12. After he had produced his second set of trading accounts (to April 2007) the business was growing well and his bank recommended he appoint a larger firm of accountants to advise him. He appointed UHY Peacheys and then handed his documents over to them in the summer of 2008 with a view to the preparation of his April 2008 accounts.

25 13. In the course of preparing those accounts, UHY Peacheys identified that CIS deductions may not have been properly operated. They advised that expense payments should be made subject to deduction. Initially Mr Nind did not believe them, and indeed he telephoned two or three different individuals within the firm to verify the position. Eventually he accepted that they were correct and changed his practices so as to deduct the full amount.

30 14. This change of practice had not long been implemented when HMRC contacted the Appellant with a view to a compliance visit, initially arranged for November 2009. The visit eventually took place in February 2010 and following that visit and further correspondence, UHY Peacheys provided HMRC with a schedule prepared from the Appellant's invoices received from its subcontractors over the years 2006-07, 2007-08 and 2008-09. For each invoice, they compared the "labour" total shown on the invoice (from which the Appellant had deducted CIS tax) with the grand total of the invoice (less the prices shown for actual materials). The difference they treated as "expenses" and they listed the expenses from each invoice in the schedule.

35 15. From this schedule, HMRC calculated that the Appellant had underdeducted £10,291.76 of tax over the three years 2006-07 to 2008-09 and indicated they would raise determinations under regulation 13(2) of the CIS Regs to recover this underdeduction.

16. The Appellant's accountants asked HMRC to make a direction under regulation 9(5) of the CIS Regs in respect of the underdeductions, so as to absolve the Appellant from liability to pay the amounts in question.

5 17. First, they expressed the view that there should have been no loss to HMRC as a result of the underdeductions and therefore "Condition B" set out in regulation 9(4) CIS Regs would be satisfied. After investigation, HMRC reduced the amount claimed by £379 for this reason. It is common ground that the Appellant has no right of appeal in relation to this decision.

10 18. Second, they asserted that "Condition A" in regulation 9(3) CIS Regs was satisfied, and the Appellant should therefore be excused from having to pay the amounts it had underdeducted.

15 19. HMRC issued a formal refusal of this application on 10 March 2011, a refusal which was ultimately confirmed after a statutory review by a letter dated 26 October 2011. The Appellant appeals against HMRC's refusal. They later issued a penalty determination on 18 April 2012 for £1,457.70, which is also under appeal.

The law

20. The basic law giving rise to the obligation to deduct tax from payments is to be found in section 61 Finance Act 2004, which provides as follows:

20 "1) On making a contract payment the contractor (see section 57(3)) must deduct from it a sum equal to the relevant percentage of so much of the payment as is not shown to represent the direct cost to any other person of materials used or to be used in carrying out the construction operations to which the contract under which payment is to be made relates."

25 21. From this, it can readily be seen that a contractor's obligation, when making payment to a subcontractor, is to deduct tax at the appropriate rate from the whole payment, excluding only that part of it that can be "shown to represent the direct cost.... of materials used or to be used in carrying out the construction operations...". In other words, the only part of the payment which is not subject to deduction is that
30 part which represents payment for materials actually used (or to be used) in carrying out the construction work covered by the relevant subcontract. It is quite clear therefore that payments to reimburse other expenses (including, but not limited to, travel or lodging expenses) are subject to deduction.

35 22. Regulation 9(5) CIS Regs provides that in two situations an officer of HMRC may make a direction which relieves the contractor from having to pay over to HMRC any shortfall in the amounts deducted by it.

40 23. The first situation is (broadly) where HMRC establish that the subcontractor was not chargeable to tax in respect of the payments, or has included the payments in a tax return which has been paid in full. Because this involves a detailed examination of the affairs of other taxpayers, there is no right of appeal for the contractor against

HMRC refusing to make a direction under this provision. There is no dispute in this case about the operation of this provision, which is called “Condition B” in the legislation.

24. The second situation is where “Condition A” is satisfied. Regulation 9(3) CIS
5 Regs provides:

“Condition A is that the contractor satisfies an officer of Revenue and
Customs –

(a) that he took reasonable care to comply with section 61 of the
Act and these Regulations, and

10 (b) that –

(i) the failure to deduct the excess was due to an error
made in good faith, or

(ii) he held a genuine belief that section 61 of the Act did
not apply to the payment.”

15 25. As mentioned above, HMRC had accepted that the Appellant’s failure to
deduct in this case was due to an error made in good faith. The only issue therefore
was whether the Appellant had taken reasonable care to comply with section 61 of the
Act (i.e. Finance Act 2004) and the CIS Regs.

20 26. Under regulation 9(6) CIS Regs, HMRC must issue any refusal to make a
direction in the form of a refusal notice which gives the grounds for the refusal. The
contractor then has a right of appeal to HMRC under regulation 9(7) CIS Regs, in
which he must demonstrate that “Condition A” is satisfied in relation to the
underdeduction.

25 27. The Tribunal’s jurisdiction derives from regulation 9(9) CIS Regs, which
provides as follows:

30 “If on an appeal under paragraph (7) that is notified to the tribunal it
appears that the refusal notice should not have been issued the tribunal
may direct that an officer of Revenue and Customs make a direction
under paragraph (5) in an amount the tribunal determines is the excess
for one or more tax periods falling within the relevant year.”

28. The above provisions applied for the period from 6 April 2007. For 2006-07,
equivalent provisions to exactly the same effect were contained in sections 559-567
Income and Corporation Taxes Act 1988 and the Income Tax (Sub-contractors in the
Construction Industry) Regulations 1993.

35 **Discussion and findings**

29. Ms Carwardine readily accepted that new evidence had been produced as a
result of the appeal which had not originally been available to the officers who had

made the original decision and then confirmed it in the statutory review. It is fair to say that in the light of the extra evidence, whilst she did not actually withdraw HMRC's case altogether, she was moderate in her support of it. In the light of the facts as they came out at the hearing, we consider she was right in this, and we welcome her reasonable approach.

30. In the circumstances, we reached the conclusion that the Appellant had taken reasonable care to comply with its obligations under section 61 Finance Act 2004 and the CIS Regs, HMRC's refusal notice should not have been issued and we therefore allow the appeal.

10 31. We accordingly set aside the penalty of £1,457.70 issued on 18 April 2012 and we direct that HMRC should make a direction under regulation 9(5) CIS Regs (or, in relation to 2006-07, the predecessor legislation) for the full amounts claimed by HMRC in respect of each of the years 2006-07, 2007-08 and 2008-09.

Future action

15 32. Mr Nind indicated that even now he still experiences occasional difficulties in getting his subcontractors to accept that deduction should be withheld from all payments except to the extent they are "shown to represent the direct cost" to the subcontractor (or some other person) "of materials used or to be used in carrying out the construction operations".

20 33. If a subcontractor submits an invoice for, say, £5,000 which includes £1,000 in respect of the cost of materials, then the Appellant will be obliged to deduct tax from £4,000 of the payment, even if the invoice is also marked with an endorsement to the effect that only, say, £2,000 of the total is attributable to "labour". If the subcontractor refuses to accept the full deduction but also fails to come up with convincing evidence to show that he really has incurred construction material costs of £3,000 (i.e. to justify his original claim that only £2,000 should be subject to deduction) then the Appellant, by only deducting CIS tax from £2,000, is personally carrying the risk of any underdeduction which is subsequently established by HMRC.

30 34. We pointed out that the CIS Regs contain a mechanism for resolving such problems. To avoid being pursued by HMRC for underdeduction, the Appellant can apply to HMRC under regulation 13(1)(a)(ii) CIS Regs to determine the correct split of the invoice between "cost of construction materials" (gross payment) and the remaining balance (subject to deduction). If in the future the Appellant simply accepts at face value a subcontractor's assertion as to the amount of his invoice that should be subject to a CIS deduction, however unsubstantiated, illogical or implausible that amount may be, the Appellant will find it very hard to persuade HMRC or a Tribunal that it "took reasonable care to comply" with its obligations under the CIS scheme.

35 35. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax

Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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**KEVIN POOLE
TRIBUNAL JUDGE**

RELEASE DATE: 2 January 2013