



HM Revenue
& Customs

Fraud on provision of labour in construction sector: consultation on VAT and other policy options

Summary of responses

1 December 2017

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Executive Summary

Why did the government consult?

Fraud in construction sector labour supply chains presents a significant risk to the Exchequer and the government announced this consultation at Spring Budget 2017 to address this. Organised criminal gangs create contrived supply chains to enable them to perpetrate what is commonly referred to as 'Missing Trader' fraud whilst operating alongside actual construction services. It is estimated that tackling it will raise an average of £100m a year.

This is most commonly found among sub-contractors who provide groups of workers to the construction sector. They have low VAT costs to recover, because their main cost is wages, which are not subject to VAT. But they are required to charge VAT on the service of supplying their workers to other contractors. An incentive therefore arises to evade the high net VAT payable by going missing or committing other forms of fraud.

With income tax, there is a failure to make the appropriate Construction Industry Scheme (CIS) deductions and remissions to HMRC which are supposed to cover workers' PAYE contributions.

What is the government proposing?

As announced at Autumn Budget 2017, for VAT the government will introduce a domestic 'Reverse Charge'. This means that the customer in the transaction becomes responsible for accounting for the VAT. The supplier will never obtain custody of the tax due and hence cannot steal it. The majority of EU member states operate a reverse charge mechanism for construction services.

With an estimated 300,000 businesses, the construction sector is much bigger and more complex than other sectors in the UK where reverse charges have been deployed in recent years. The government listened to stakeholder concerns about the impact on legitimate businesses and will ensure:

- a long lead-in time for businesses to make necessary adjustments to their accounting and IT systems. The measure will only take effect in October 2019.
- sales to the final business or domestic customer are out of scope of the VAT reverse charge. This will reduce complexity for developers without reducing the measure's effectiveness.
- there will be no threshold to avoid creating considerable complexity for businesses and offering fraudsters a means to avoid the measure.

For income tax, the government will not proceed with the measures discussed in the consultation regarding making the qualifying criteria for Gross Payment Status (GPS) in the Construction Industry Scheme more stringent. The government listened to the feedback issued by stakeholders that the impact on legitimate businesses would be disproportionate to the level of the fraud the proposal would address.

HMRC will increase its compliance response to more robustly assess businesses applying for GPS for evidence of fraudulent activity.

1. Introduction

The consultation

1.1 HMRC published the consultation on fraud in labour supplies within the construction sector on 20 March 2017. The consultation sought views on policy options for VAT and in the Construction Industry Scheme (CIS). Comments were invited by 9 June 2017. This deadline was extended to include follow up face to face meetings.

1.2 The consultation set out how the fraud works and HMRC's operational response. It also explained that a consultation was appropriate in these circumstances because of the size and complexity of the construction sector.

1.3 On VAT, the consultation focused on options for a domestic reverse charge and on CIS, measures that could be taken to stop the fraudulent use of Gross Payment Status (GPS). Respondents were asked to consider the:

- scope of a VAT reverse charge, in particular, whether final business customers should be included where they are VAT registered, and whether a threshold would help reduce the impact on small businesses, whilst remaining an effective anti-fraud measure; and
- qualifying criteria for GPS within CIS and whether it should be more restrictive, and whether there are information sources relevant to the fraud that contractors should report to HMRC.

1.4 Respondents were invited to suggest other options that might be effective in combatting the fraud. HMRC also included initial assessments of the impacts the VAT and CIS options could have and respondents were asked to comment on them.

Consultation responses

1.5 We are grateful to everyone who took the time to respond to the consultation exercise. We received 54 written responses from a variety of businesses from small to large, tax representatives and trade associations. We also held face to meetings with large construction businesses, utilities businesses, tax representatives and trade associations. The responses and discussions have been extremely useful in helping HMRC understand the potential impacts and respondents' views and concerns.

1.6 Chapter 2 of this document gives an overall summary of the comments and also sets out responses on a question by question basis.

1.7 Chapter 3 of this documents outlines the government's response to the consultation.

1.8 Chapter 4 sets out the next steps.

1.9 Annex A contains a list of stakeholders who responded to this consultation.

2. Responses

General comments from meetings and written responses

VAT

- 2.1. The majority of respondents expressed a willingness to assist HMRC and understood the need to take action against the fraud. This included assisting HMRC with operational measures where it was practical to do so.
- 2.2. The majority of respondents raised some issues over the introduction of a reverse charge, highlighting the scale and complexity of the sector. Many contributors' mentioned the one off costs associated with changing their accounting systems and time spent training staff. Responses indicate that the costs involved will vary depending on the size of the business and complexity of their accounting system. Cash flow impacts were also mentioned by some businesses that use the VAT they collect as part of their working capital (under a reverse charge the VAT is accounted for by the recipient of the supply).
- 2.3. Most respondents asked that there should be a long lead in time for any implementation (this varied from 6 months to 2 years) and that clear and comprehensive guidance material is provided as early as possible to assist businesses make the changes. Larger businesses indicated they would only start working on IT changes once the detail of the final legislation was known to avoid any unnecessary costs. Having a longer lead in time would also allow businesses time to adjust to the new cash flow arrangements.
- 2.4. Some comments were made about the consequences of making errors with a new policy, particularly small businesses when they were doing their best to comply. Other comments were made about customers not paying the reverse charge correctly (this was raised by some in the utilities sector).
- 2.5. For the scope and definition of reverse charge supplies, most contributors thought something that mirrors the CIS definition as much as possible would be most practical.
- 2.6. Thresholds were not considered workable by industry respondents although some tax professionals thought they could be made to work if small businesses needed to be excluded. The general view was that it would be difficult to work out at what stage a threshold had been reached and that including one as part of the policy design could undermine the anti-fraud effectiveness of the measure.
- 2.7. There were different views about whether supplies to VAT registered final customers should be subject to the reverse charge (customers who are not VAT registered are already excluded from existing reverse charge measures). Tax professionals felt that the complexities of including such supplies for certain customers should be avoided whereas others, including developers, felt it was simpler to include all final customers who were VAT registered.
- 2.8. Some contributors mentioned that several other EU countries had introduced

domestic VAT reverse charges in their construction sectors and the UK could learn lessons from them. Questions were also raised about how contracts which span a significant length of time would be affected by a domestic reverse charge.

CIS

2.9. For CIS, there were mixed responses to making GPS more restricted. Some people thought that tightening up the qualifying rules was a good idea in the context of fraud. The majority, however, thought that the impact of losing GPS for small businesses would be significant and not welcome in the industry. Nor did they think that it would stop the fraudsters who would probably be able to adjust to any new criteria.

2.10. Some thought GPS should only be available for businesses that had been compliant with submitting VAT returns (the qualifying period varied between 2 to 5 years). It was also thought aligning it with the VAT registration process might help.

2.11. Other suggestions put forward included making all workers employees and therefore fall under PAYE regulations. HMRC should also take on more compliance staff and monitor sub-contractors whose turnover has significantly increased by making better use of information already available.

2.12. Asking businesses to keep track of change of ownership of companies was not thought possible in many cases or proportionate to its cost. Also HMRC has access to some of this information already via Companies House and the burden should not be put on the industry to monitor this.

2.13. A number of respondents thought there must be a way that HMRC should be able to prevent applications which on the face of it pass the GPS test but have been submitted by fraudsters. Indicators like very new companies and directors with little or no history with HMRC should be checked further.

Responses to consultation questions

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

2.14. Respondents had differing views about whether the reverse charge should apply to supplies to the final customer. The majority favoured excluding them from the measure.

2.15. Builders, contractors and tax professionals tended towards the end user being excluded, whereas property investors/developers preferred the end users to be included. Some developers were concerned that having exclusions might mean the reverse charge would be less effective at tackling the fraud.

2.16. There were concerns that the final customer is not obvious in all cases, particularly with joint ventures and the use of special purpose vehicles as subsidiaries in the voluntary and public sectors. Some respondents suggested that a reverse

charge should apply to those who have to submit CIS returns.

2.17. Some respondents commented that as the fraud was not taking place with end users, at the end of the supply chain, it would not be appropriate to include them in the reverse charge.

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?

2.18. The vast majority of respondents were not in favour of a threshold, and therefore did not suggest a monetary value. They thought a threshold would be too complex, susceptible to the risk of error and thresholds could be manipulated and susceptible to fraud. Respondents also commented that it was a commercially sensitive issue.

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

2.19. The general view was that if everything fell under the reverse charge, there would be no need to designate a main contractor. If this were not the case, then defining the main contractor would be more difficult.

2.20. Respondents commented that they would need clear guidance on this matter. The most common proposed solution was adoption of the CIS definitions, updated as necessary for the purposes of the reverse charge.

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?

2.21. None of the respondents gave a reason why architects or engineers should be treated differently. Also, there was a strong view that, for simplicity purposes, everyone should be treated the same, according to their role in the supply chain.

Question 5: What are your views on using the CIS definition as the reverse charge definition? Are there other options that should be considered?

2.22. There was general consensus that using the CIS definition as a basis for a reverse charge made sense, as it is generally well understood. It was, however, pointed out that CIS has areas of uncertainty and these would need to be clarified for a reverse charge.

2.23. Some tax professionals suggested that the definition should be drafted to fit in with existing VAT legislation around construction rather than follow the CIS legislation.

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?

2.24. The majority of respondents were of the view that it was not possible to narrow the CIS definition to exclude small businesses. If a threshold was introduced, all businesses would have to monitor and assess the risk of passing the threshold, which could lead to confusion, error and manipulation. However, some respondents said they would prefer a threshold to be based on annual turnover if it was felt necessary to have one.

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

2.25. The majority of respondents said this would cause confusion and there would be a risk of error and manipulation. However, if there were to be a threshold set on this basis, an amount of £5,000 was suggested.

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?

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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?

2.26. Respondents were strongly against the application of a threshold. They thought that it would be complicated, cause confusion, not be practical and would be open to manipulation and abuse. There were also concerns about the practicalities of programming IT to deliver this.

2.27. An annual sales based threshold was seen as the least complicated option (if there was a threshold) but overall respondents were clear that they preferred not to have one.

2.28. Utilities businesses highlighted that under OFGEM rules they often have to refund and re-charge costs associated with adding power connections to existing networks – the “second comer” rules. When a new or 2nd customer is linked to a network paid for by an earlier or 1st customer, the utility will refund the 1st customer part of its costs and re-charge that to the 2nd customer. Any thresholds could further complicate and delay what is already an often difficult task.

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

2.29. Overall, the majority of respondents commented that self-billing should not be a problem.

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

2.30. Those that commented, thought that the reverse charge would have an impact on FRS users as they would no longer receive VAT on their supplies but would still have to account for VAT at their fixed percentage rate. Most would therefore have to leave the FRS.

2.31. A minority of respondents said that a reverse charge should not apply to FRS users and to exclude FRS users, a de minimis limit of £150,000 was suggested.

Question 12: If a reverse charge were 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?

2.32. The length of time needed varied between 6 months and 2 years, with the majority stating it would take at least 1 year to design, train staff, test and implement. All who commented on this aspect thought it would be a significant change for them to make.

2.33. Some thought a threshold would make no difference but others, including software developers thought it would take longer to implement with a threshold.

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

2.34. It was pointed out by a few of the respondents that as the fraud was being perpetrated by companies, then it should be restricted to them. However, it was pointed out by the majority of respondents that fraudsters would simply circumnavigate this by using partnerships. It was also said that for simplicity, all entities should be treated the same.

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?

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Question 15: If the threshold were 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? Should the increased threshold apply if an applicant's controlling company already has GPS?

2.35. It was widely stated that any changes to the gross payment status qualification rules would be likely to hit legitimate businesses without stopping the fraud.

2.36. Some suggested that if an applicant had not traded and is not owned by businesses with GPS then it should be subject to a higher turnover threshold.

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

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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?

2.37. Whilst all contributors have stated that they are willing to assist HMRC in tackling fraud in the industry, they feel that this suggestion would be impractical. It would be onerous and difficult to track and several people have said that HMRC

could get the information directly from Companies House without the need to put the burden on the industry.

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?

2.38. It was generally felt that any changes in the GPS qualification rules, would hurt legitimate businesses without stopping the fraud. The suggestion may even be a factor in discouraging honest people from working in construction.

2.39. Respondents felt that HMRC should be doing more to stop GPS applications from fraudsters, particularly with the amount of data it holds on individuals and businesses.

2.40. One professional body suggested that HMRC use a wider validation process for businesses registering for GPS.

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

On VAT, respondents suggested a number of options, including altering the registration threshold, liability options and changing the frequency of VAT returns. There were also options for making more of the linkages between VAT and CIS – and options around HMRC resourcing.

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

2.41. The overall view from the responses was that a VAT reverse charge would be a significant change to make. There would be costs for IT and training, transitioning to a new VAT accounting arrangement and some would have their cash flow affected.

2.42. Some respondents commented that this proposal would be complex for some businesses, particularly those that applied more than one VAT rate to their construction services. Good education and communication would be essential.

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.

2.43. Respondents commented that this would be a challenge for small businesses. It was restated that cash flow would be impacted and some were torn between wanting to exclude small business by means of a threshold and knowing that this would make the whole regime far more complicated.

Government Response

3.1 This chapter sets out the government's response to the points raised in the consultation.

A VAT reverse charge

3.2 Having carefully considered the responses to this consultation, the government has decided to proceed with the introduction of a domestic VAT reverse charge for supplies of construction services. The government recognises the challenges that such a change will entail for the sector, but considers that this is the most appropriate VAT policy response to the fraud. The government recognises the impact on businesses in terms of familiarisation with the new VAT accounting mechanism, making the necessary accounting changes and making sure counter-parties are also aware. We have also talked to colleagues elsewhere in the EU to learn lessons from them.

3.3 Listening to the feedback from the consultation and to mitigate the identified impacts of implementation, the government has decided to give a long lead in time, with the new reverse charge coming into effect from 1 October 2019. This should give sufficient time for businesses to prepare for the changes and for businesses to work with HMRC to understand what it means for them. It will also give businesses time to make any necessary preparatory changes to their cash flow.

3.4 In terms of the design and scope of the reverse charge, the government believes it should follow the Construction Industry Scheme definition for construction services and have as few exceptions as possible. These exceptions will, however, include zero-rated supplies such as new housebuilding.

3.5 The government agrees with the majority of respondents that a threshold, whether based on supply value or turnover, will be difficult for businesses to administer and would represent an ongoing fraud risk. We think the downsides exceed the benefits of having one. The longer lead in time will give all businesses time to prepare for the changes and HMRC will be developing help and support, particularly for the smallest businesses. Our experience in other sectors is that once the changeover to a reverse charge is made, and businesses get used to it, it can be operated relatively straightforwardly.

3.6 For Flat Rate Scheme (FRS) users, the government believes that having an exclusion would create an added on-going burden for the sector at the part of the supply chain most vulnerable to fraud. Therefore, on balance, it has decided that the reverse charge will be easier to administer for businesses and more effective in tackling the fraud if it applies to FRS users.

3.7 Although more finely balanced in terms of responses, the government has decided that as the fraud is not found at the final customer stage it will exclude supplies to the final customer. The more detailed technical consultation to follow on draft legislation will address any definition issues for this exception.

The Construction Industry Scheme

3.8 Having taken into consideration the consultation responses the government has decided not to make changes to the structure of CIS. Instead HMRC is increasing compliance responses in order to stop fraudsters obtaining GPS and removing GPS where the applicant is no longer fit and proper person under section 74 of 2004 Finance Act.

3.9 The government welcomes the fact that respondents want HMRC to do as much as possible to clamp down on the fraud and understands why they felt raising the threshold for GPS would impact on legitimate businesses. The government will consider whether changes to the qualifying criteria for GPS are necessary in light of HMRC's increased compliance activity.

Other suggestions and conclusion

3.10 The government is grateful for the additional ideas put forward. Overall, we think the introduction of the VAT reverse charge, with a long lead in time, coupled with an immediate increase in HMRC's compliance activity in policing GPS status, provides the right approach to tackling this fraud. We will keep other ideas under review.

4. Next steps

4.1 HMRC will publish a technical consultation on draft legislation for a VAT reverse charge in spring 2018, with the legislation to be implemented with effect from 1 October 2019. A final draft of the legislation and guidance will be published by October 2018. During this period, HMRC will set up stakeholder implementation groups to work with businesses to support them in making the change.

Annexe A: List of stakeholders consulted

- Abbey Roofing Specialists Ltd
- Amey PLC
- Association of Accounting Technicians
- Aviva
- BAM Construct UK
- BAM FM Ltd
- BAM Nuttall
- BAM Properties Ltd
- BBK
- BN Kaushal Ltd
- BR Hodgson (Holdings) Ltd
- Balfour Beatty PLC
- Bouygues UK
- British Land
- British Property Federation
- British Universities Finance Directors Group
- Building Engineering Services Association
- Business Application Software Developers Association
- Cadent Gas Ltd
- Carillion PLC
- Centrica
- Chartered Institute of Taxation
- Civil Engineers Contractors Association
- Coins
- Courts and Co
- DAGTVA
- Derwent London
- Electricity North West
- Eon
- Fitzgerald Civil Engineering Contractors
- Forsters LLP
- Galliford Try PLC
- Gipping Construction
- Grosvenor Estate
- Helme and Hallett Ltd
- ILEC-IMEC Building Services
- Institute of Chartered Accountants in England and Wales
- JJ Lawrence Electrical Ltd
- Joint Taxation Committee of Construction
- Jones Bros
- Kier Group PLC
- Leiths (Scotland) Ltd
- Lowe Holdings

- M & G Investments
- Morgan Sindall Group PLC
- Morson Group
- Multiplex Construction Europe Ltd
- National Federation of Demolition Contractors Ltd
- National Housing Federation
- OCL Facades Ltd
- Quintain
- RPC
- RSM
- SSE PLC
- Segro PLC
- Scottish Power
- Standard Life Group Tax
- Tapper Interiors Ltd
- Taylor Hart Ltd
- Taylor Wimpey PLC
- Thomas and Young Ltd
- Transport for London
- UK Power Networks
- Wates
- Willmott Dixon