

Construction Industry Scheme Report by the Internal Audit Manager

1 Purpose of Report

The Internal Audit Section were requested to review the controls operating over the Construction Industry Scheme following an inspection by HM Revenue and Customs (HMRC) and the purpose of this report is to present the findings from this review.

2 Background

2.1 The Construction Industry Scheme is a HMRC tax deduction scheme that requires organisations to make deductions from payments to certain construction industry subcontractors and pay this tax directly to HMRC on a monthly basis. (See Appendix 1)

2.2 HMRC has three levels of deduction applicable to subcontractors. They can be classified as “gross”, requiring no tax to be deducted, “net” requiring tax at a standard rate (currently 20%) and “unregistered” requiring tax at a higher rate to be deducted. Midlothian does not currently have any unregistered subcontractors.

2.3 During a recent HMRC inspection of Midlothian Council it was identified that insufficient tax had been deducted from construction company invoices because of insufficient scrutiny by authorising managers on the split of materials and labour shown on the supplier invoices. A penalty was imposed on the Council but suspended on 3 conditions:

1. the Council must meet all notification and filing obligations;
2. the Council should put procedures in place to ensure checks are being carried out on invoices; and
3. Internal Audit should review the Construction Industry Scheme annually.

This is the first annual review.

2.4 In January and February 2015 briefings were provided to 62 staff in Property and Facilities Management and Commercial Operations to ensure authorising managers had an understanding of the scheme.

3 Report Approach, Findings and Recommendations

3.1 Approach

The process of verifying subcontractors with HMRC was tested, ensuring the subcontractors were classified appropriately between gross subcontractors who are paid the full amount of their invoice and net subcontractors who have tax deducted at source.

For the net subcontractors:

- the split of materials and labour on the invoices was tested to ensure this had been checked by the authorising managers and deemed appropriate;
- the accuracy of the calculation of tax deducted was tested; and

- the monthly returns to HMRC were tested for accuracy and that they were in accordance with the purchase ledger records.

3.2 Findings and Recommendations

The monthly reporting to HMRC is satisfactory and Internal Audit will review the scheme annually. A single supplier was found to be carrying out construction related work but had not been identified as a subcontractor, this has since been amended. Other than this no errors were found in the invoice samples reviewed, and there is evidence that the process of checking invoices has improved. As a result we expect that the suspended penalty can be withdrawn. However, to ensure that the quality of the process is maintained we have raised the following recommendations:

Recommendation 1

Training should be delivered annually to ensure relevant managers have an understanding of the scheme and remain aware of the importance of classifying construction suppliers as subcontractors and checking the materials and labour split on the subcontractors' invoices.

(Head of Property and Facilities Management and Head of Commercial Services / 31 March 2016)

Recommendation 2

Managers use the list of net subcontractors they were provided with during the training sessions as a reference when they are checking invoices. The Creditors section should re-issue the list of net subcontractors to authorising managers regularly to ensure they have up to date information.

(Business Applications Manager/ Complete)

Management comment: Now complete, report generated and issued automatically from the Finance system on a fortnightly basis.

Recommendation 3

The process of entering information into the HMRC web form is time consuming because the report from the purchase ledger is sorted according to supplier number but the web form is sorted alphabetically. The purchase ledger report should be amended to sort the supplier information alphabetically, and to show a count of suppliers and totals for each column. This would make the monthly reporting to HMRC less time consuming and reduce the risk of error.

(Business Applications Manager / 31 December 2015)

4.1 Resource

The recommendations listed above can be met from existing resources.

4.2 Risk

Maintaining the improved processes will minimise the risk of HMRC penalties being applied in any future inspection.

4.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- Community safety
- Adult health, care and housing
- Getting it right for every Midlothian child
- Improving opportunities in Midlothian
- Sustainable growth
- Business transformation and Best Value
- None of the above

4.4 Key Priorities within the Single Midlothian Plan

This report does not relate directly to the key priorities within the Single Midlothian Plan.

4.5 Impact on Performance and Outcomes

There will be no direct impact on performance and outcomes with regard to this report.

4.6 Adopting a Preventative Approach

Adopting the recommendations will assist with the reduction of risk and therefore provides a preventative approach.

4.7 Involving Communities and Other Stakeholders

There are no communities or other stakeholder issues with regard to this report.

4.8 Ensuring Equalities

There are no equalities issues with regard to this report.

4.9 Supporting Sustainable Development

There are no sustainability issues with regard to this report.

4.10 IT Issues

There are no IT issues with regard to this report.

5 Summary

Following an adverse inspection by HMRC a suspended penalty was applied to the Council. It is expected that the improvements in the process will allow the penalty to be avoided.

6 Recommendations

The Audit Committee is invited to:

- note the content of the report; and
- endorse the recommendations in the report.

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Gov.uk What is the Construction Industry Scheme?

1 Construction Industry Scheme (CIS)

Under the Construction Industry Scheme (CIS), [contractors](#) deduct money from a [subcontractor](#)'s payments and pass it to HM Revenue and Customs (HMRC).

The deductions count as advance payments towards the subcontractor's tax and National Insurance.

Contractors must register for the scheme. Subcontractors don't have to register, but deductions are taken from their payments at a higher rate if they're not registered.

1.1 Who counts as a contractor or subcontractor

[Register as a contractor](#) if either:

- **you pay subcontractors for construction work**
- **your business doesn't do construction work but you spend an average of more than £1 million a year on construction in any 3-year period**

[Register as a subcontractor](#) if you do construction work for a contractor.

You must register as both if you fall under both categories.

1.2 Work covered by CIS

CIS covers most construction work to buildings, including site preparation, decorating and refurbishment.

Exceptions

You don't have to register if you only do certain jobs, including:

- **architecture and surveying**
- **scaffolding hire (with no labour)**
- **carpet fitting**
- **delivering materials**
- **work on construction sites that is clearly not construction, eg running a canteen or site facilities**

The [CIS guide for contractors and subcontractors](#) explains what is and isn't covered by the scheme.

1.3 Your business is based outside the UK

The same CIS rules apply if your business is based outside the UK, but you do construction work as a contractor or subcontractor in the UK. [Read more](#) about how to register and pay tax if this applies to you.