

# Tax in the construction industry: Q&A

by [Kyle Rainsford](#), Senior Counsel at [Travers Smith](#)

Sector notes | [Law stated as at 10-Jan-2024](#) | United Kingdom

---

A Q&A guide to tax issues in the construction industry. A high-level overview of the taxes and reliefs of particular relevance to the industry, the sources of those tax rules, the policy context, and developments on the horizon.

---

## Taxes specific to, or of particular relevance to, the industry

### 1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.

#### Construction industry scheme

The construction industry scheme (CIS) was introduced to prevent perceived tax evasion in the construction industry. It is a type of withholding at source, like *pay-as-you-earn* or interest withholding tax (see [Practice note, Withholding tax](#)). Under the CIS those who make payments for construction services (contractors) may be required to deduct income tax from payments to those who perform the services (sub-contractors). The CIS only applies to labour costs; no deduction is required to the extent that a payment is for building materials.

Not all payments will fall under the CIS. The person making the payment must be in the construction industry (a mainstream contractor) or have spent at least £3 million on construction expenditure in the last 12 months (a deemed contractor) to be required to register as a contractor under the CIS and make deductions.

The rate of deduction under the CIS, if the subcontractor is registered in its capacity as such with HMRC, is the basic rate of income tax, currently 20%. The rate increases to 30% if the subcontractor is not registered with HMRC. It is also possible for subcontractors to apply to HMRC to obtain gross payment status (see [Practice note, Construction Industry Scheme \(CIS\): Contractor's gross payment status](#)) if they have a good compliance history, enabling them to be paid without deduction under the CIS.

There are exceptions to the CIS, including for payments made by a person for works on a property they use for their business and for reverse premiums to induce tenants to take new leases. HMRC have recently consulted and agreed to broaden the latter exemption to encompass the majority of landlord-to-tenant payments. See [Practice note, Construction Industry Scheme \(CIS\): Exceptions, Article, Construction industry scheme: HMRC consultation, Practice note, Property inducement payments: tax: Construction Industry Scheme \(CIS\) and 20. What developments in taxation are on the horizon that will affect this industry in particular?](#) .

For an overview of the CIS generally, see [Practice note, Construction Industry Scheme \(CIS\)](#).

#### Value added tax domestic reverse charge

The value added tax (VAT) domestic reverse charge (DRC) was announced in 2017 and came into force in 2021. Like the CIS, it is intended to counter fraud in the construction industry; in this case the fraud of supplier collecting output VAT from the payer but deliberately failing to account for that VAT to HMRC. The DRC solves this issue by requiring the payer to charge itself VAT as though it were the supplier, so the VAT amount never passes through the supplier's hands.

The DRC applies to supplies of construction services, together with goods if they are supplied in the course of construction (unless there is a separate supply of those goods). The definition of "construction services" is broadly identical to the definition used for the CIS. In general, the DRC does not apply where the CIS does not; including where, for example, one of the CIS exemptions applies.

The DRC does not apply to what the legislation calls "end users", that is, those who receive supplies of construction services but do not themselves make any supplies of construction services. It also does not apply to "intermediary suppliers" who are connected with end users or who have an interest in the same property as an end user. The broad intent of these exclusions is to ensure that the DRC does not apply to those who are not themselves in the construction industry. However, there is a notification requirement before the DRC is turned off for an end user or an intermediary supplier, and if this is missed then the reverse charge obligation will still bite on the recipient.

For more information, see [Practice note, VAT reverse charge on construction services](#).

### **Residential property developer tax**

The residential property developer tax (RPDT) was introduced with effect from April 2022 to provide funds to remediate defective cladding. It applies to the UK residential property development profits of corporation taxpayers. The rate is 4% and applies to profits over a threshold of £25 million.

RPDT is paid and collected as though it were corporation tax. For more information, see [Practice note, Residential property developer tax](#).

## **2. Are there aspects of corporation tax or any other general taxes that are particularly relevant to those operating in the industry?**

No. For a general summary of UK corporation tax, see [Practice note, Corporation tax: general principles](#).

## **3. Do the taxes encountered drive any particular conventions within the industry, for example, as to how people are employed or how commercial transactions are structured?**

The availability of the VAT zero rate on construction of dwellings, including student accommodation, has encouraged the adoption of wider ranging "design and build" contracts (see [Practice note, Procurement: common construction procurement methods: Design and build procurement](#)). In other, more typical arrangements, professional fees, such as the fees of planning consultants and architects, are typically standard rated, and, if the recipient intends to hold the development for rental, that VAT may be irrecoverable. Even if it is recoverable, there is a cashflow cost in funding the VAT element and waiting for its recovery. By contrast, if the services are supplied by a single developer under a single design and build contract then, provided the services can be regarded for VAT purposes as a single supply with the construction element predominating, the whole supply will be zero rated.

## **4. How does VAT apply to the industry's main business activities?**

The VAT DRC can mean that the recipient, rather than the supplier, must account for VAT on certain construction services supplied within the construction industry. See *1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.* for more detail.

The construction of residential property can have several different VAT treatments.

### **Dwellings**

The supply of construction services in the course of the construction of a building designed as a dwelling or a number of dwellings (such as a house or a block of flats) attracts a rate of 0%. There are several conditions that have to be met for a building or unit to be a "dwelling", including a requirement for no internal access between units as well as the necessities of life (which include a kitchen and bathroom). In addition, planning permission must allow residential use and cannot prohibit the separate disposal of the units.

### **Relevant residential or charitable purpose**

The supply of construction services in the course of construction of a building intended for use solely for a "relevant residential purpose" (RRP) or a "relevant charitable purpose" (this includes, for example, student accommodation and care homes) can also attract the 0% rate.

However, unlike for dwellings, this rate applies only where those services are supplied directly to the person who is going to use the property for that purpose (and they must issue a certificate to this effect). Construction services supplied to a landlord or property developer may therefore still be subject to VAT at the rate of 20%. There is a "change of use" clawback rule which applies to recipients of zero-rated services for relevant residential or relevant charitable purposes.

Historically, HMRC took the view that as student accommodation fell within the RRP definition, the RRP rules rather than the dwelling rules applied to its construction. However, in 2014 they changed this position, accepting that student accommodation which met the conditions for being dwellings could be zero-rated under the more relaxed conditions that apply to dwellings (see *Practice note, VAT zero-rating of student accommodation*).

### **Conversion**

The conversion of non-residential property to residential can attract the reduced rate of VAT, which is currently 5%. The reduced rate can apply to:

- A conversion where a dwelling is added where one did not exist before, or where the number of dwellings is increased.
- A conversion of a building from a single household dwelling to a house of multiple occupation.
- A conversion of a building for use for RRP.

As for the zero rate, an additional requirement in the case of RRP is that the recipient of the construction services must be the person putting the property to use for the RRP.

### **Building materials**

The zero rate and the reduced rate extend also to supplies of building materials as part of the same supply as the construction services. "Building materials" is defined by statute as "goods of a description ordinarily incorporated by builders in a building of that description" and does not include, for example, white goods. There are other particular exclusions from "building materials" including for fitted furniture and electrical and gas appliances. The supply of those items is likely to be standard rated.

For more information, see *Practice note, VAT and property: an outline of the rules: Non-commercial buildings*.

**5. Will the OECD's Pillar 2 proposals have any particular impact on those operating in the industry?**

No. (For an overview of these proposals, see *Practice note, OECD Inclusive Framework proposal for global minimum corporate tax rate*).

**Tax reliefs specific to, or of particular relevance to, the industry**

**6. Are there any tax reliefs, incentives or exemptions that apply only to this industry?**

No.

**7. What is the rationale for these reliefs or exemptions?**

Not applicable.

**8. Are there any other reliefs or exemptions that are particularly relevant to this industry?**

No.

**Sources of tax rules in the industry**

**9. Which are the key pieces of UK legislation governing the tax regime in the industry?**

**Construction Industry Scheme**

The construction industry scheme is contained in Part 3, Chapter 3 of the *Finance Act 2004* as well as regulations laid as the *Income Tax (Construction Industry Scheme) Regulations 2005* (as amended).

**VAT domestic reverse charge**

The VAT domestic reverse charge is included in *section 55A* of the Value Added Tax Act 1994, with further detail in the statutory instrument laid as the *Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019 (SI 2019/892)*.

**Residential property developer tax**

Residential property developer tax is contained in sections 32 to 52 of, and Schedules 7 to 9 to, the *Finance Act 2022*.

**10. Is governance of any aspects of the tax regime applicable to this industry devolved to the Scottish Parliament or Welsh National Assembly?**

No.

**11. Are there any manuals or other published HMRC materials particularly relevant to the industry?**

Yes. They are:

- CIS Reform Manual (*HMRC: CIS Reform manual*).
- VAT Construction Manual (*HMRC: VAT Construction*).
- VAT reverse charge guidance (*GOV.UK: VAT domestic reverse charge technical guide*).
- Residential property developer tax manual (*HMRC: Residential Property Developer Tax manual*).

**12. Are there any industry codes of practice particularly relevant to tax in the industry?**

No.

## **Taxes and ESG in the industry**

**13. Are there any tax rules designed to encourage organisations in the industry to behave in a more environmentally friendly manner?**

No. (For an overview of key considerations arising for the construction industry in relation to climate change, see *Sector note, Climate change and the construction industry* and for developments in relation to zero carbon buildings, see *Practice note, Zero carbon buildings*).

**14. Are there any tax rules designed to compensate for perceived detriment to society or the environment arising from industry practices?**

Yes, RPDT (see *1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.*) was introduced to provide funds to remediate defective cladding. In February 2021, the Government announced an additional £3.5m investment in building safety which included a commitment to fully fund the replacement of unsafe cladding in residential buildings 6 storeys and over in the UK. According to the Housing Secretary this is partly funded by the RPDT as a "tax on developers to contribute to righting the wrongs of the past". As part of the same package a building safety levy will be introduced. See *20. What developments in taxation are on the horizon that will affect this industry in particular?* and *Practice note, Building Safety Act 2022: Building Safety Levy* for more detail.

## **Avoidance, enforcement and penalties**

**15. Are there any anti-avoidance measures or rules that relate specifically to the industry, or are particularly relevant to the industry?**

Yes. HMRC appears to view the construction industry as an industry in which the opportunity for evasion is particularly heightened, and so there are now two separate regimes (the CIS and the VAT DRC) which are aimed at eliminating or reducing such opportunities by ensuring that the amount which is owed to HMRC is accounted for by the payer rather than the payee.

See *1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.* and *20. What developments in taxation are on the horizon that will affect this industry in particular?.*

**16. Are there any key tax cases of note involving businesses in the industry, or on issues or with fact patterns that commonly arise in the industry?**

*Ardmore Construction Ltd v Revenue and Customs Commissioners [2018] EWCA Civ 1438* is an important case on whether interest has a UK source for the purpose of withholding tax on interest.

The taxpayer in that case was a UK construction company. Both the First Tier and Upper Tribunals decided that the payment did have a UK source on the basis of the presence of a number of factors, one of which was that the business of the borrower was carried on in the United Kingdom and therefore this was the ultimate source of the funds used to repay the interest. The Court of Appeal confirmed this was a fact it was open to the Tribunal to find and that it would not seek to interfere with that finding (see *Legal update, Practical approach to multifactorial test of source of interest (Court of Appeal)*). The ongoing impact of the analysis in *Ardmore* and its reconciliation with prior case law on UK source is yet to be seen.

**17. Are there any recent examples of HMRC investigations focused on organisations in the industry?**

No.

**18. Are there any rules imposing obligations specifically on organisations in the industry to report to HMRC?**

As well as being a mechanism for the collection of tax at source (see *1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.*), the CIS also functions as a reporting mechanism. Contractors (that is, persons making payments in the construction industry) who are required to be registered under the scheme must make monthly CIS returns to HMRC detailing the total amounts of payments they have made to each subcontractor, the cost of building materials, and the amount of tax withheld.

## Policy and horizon scanning

**19. What are the key priorities governing the tax regime in the industry?**

See *14. Are there any tax rules designed to compensate for perceived detriment to society or the environment arising from industry practices?* and *15. Are there any anti-avoidance measures or rules that relate specifically to the industry, or are particularly relevant to the industry?.*

**20. What developments in taxation are on the horizon that will affect this industry in particular?**

HMRC consulted on changes to the CIS in April 2023 and announced the results of the consultation in November 2023. Two key anticipated changes are:

- In assessing gross payment status, HMRC will now be permitted to consider the VAT compliance history of the relevant subcontractor. This change has been included in the Finance Bill 2024 currently before Parliament and

expected to be enacted in the first half of 2024. The effective date of these changes in the Bill as introduced is 6 April 2024 (clause 34).

- The majority of landlord-to-tenant payments will be removed from the scope of the CIS, subject to an avoidance test. This will be introduced by regulation. HMRC will also continue to consider ways to simplify the regime and remove unnecessary administrative costs.

See *1. Please list and briefly summarise the policy and general operation of any industry-specific taxes, duties or tax regimes.*, *Practice note, Finance Bill 2024: business tax provisions analysis: Evasion and avoidance* and *Legal update, 2023 Autumn Statement: key business tax announcements: Construction industry scheme reform*.

Originally announced in 2021, the Building Safety Levy is the second new tax intended to help fund the cost of remediating faulty cladding. The Building Safety Levy was the subject of two HMRC consultations, the last of which closed in February 2023. While the design and scope of the levy is still not determined, it is likely to apply to new residential developments and be levied on either floor area or the number of residential units. It is anticipated to be collected by local authorities, with rates depending on geographic region as well as whether the site is greenfields or brownfields. Draft legislation and the final proposed form of the levy is awaited. For more information see *Practice note, Building Safety Act 2022: Building Safety Levy*.

## **21. Are there any other features of the UK tax regime that are specific to this industry?**

No.

---

END OF DOCUMENT
-----------------