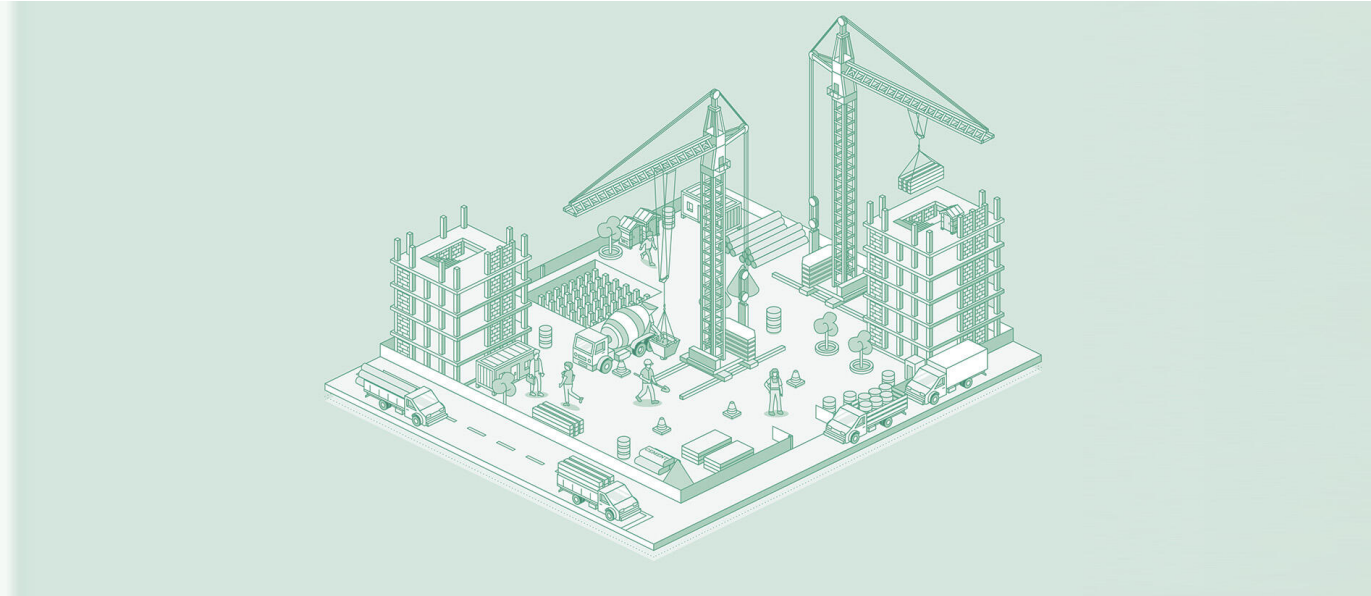
The rules of CIS: a guide for subcontractors

Property Tax | Large Corporate | OMB | Indirect Tax



26 November 2025

p>The definition of subcontractor can apply to more than just UK construction companies. Awareness of the rules is key to help cash flow and enhance credibility.

Key Points

What is the issue?

The definition of a subcontractor is intentionally broad, and many businesses, individuals and organisations can fall within its scope. The territorial scope of the CIS means that even overseas subcontractors working on projects wholly or partly in the UK or its territorial waters can be caught.

What does it mean for me?

Obtaining gross payment status can be challenging, is not guaranteed and is hugely valuable for subcontractors. Once obtained being tax compliant is important or gross payment status can be lost.

What can I take away?

The VAT Domestic Reverse Charge for Construction is also an issue for subcontractors who need to consider how it applies to the supplies they make or receive, the effect on invoicing and accounting processes, and the potential impact on cashflow.

The Construction Industry Scheme (CIS) is a complex system that affects a wide range of businesses involved in UK construction work, including many that may not realise they fall within its scope. From understanding who qualifies as a subcontractor to navigating registration, gross payment status, and the VAT domestic reverse charge, compliance is key to maintaining credibility and managing cash flow effectively.

We consider the CIS framework from a subcontractor’s perspective, outlining how it applies to both UK and overseas entities, the process of securing and retaining gross payment status, and the administrative and financial implications of non-compliance.

What is a subcontractor?

Under Finance Act 2004 s 58, a subcontractor is defined as a party to a construction contract (as outlined in s 57(2)) with a contractor, and who meets any of the following conditions:

- is under a contractual obligation to execute the construction operations specified in the contract;
- provides their own labour to carry out construction operations, such as a labour only subcontractor;
- in the case of a company, provides the labour of employees or officers to carry out construction operations;
- provides or arranges the labour of others to carry out the operations – for example, a labour agency; or

- is answerable to the contractor for ensuring the work is carried out by others, whether under a contract or other arrangements.

This definition is deliberately broad, reaching far beyond the obvious example of a building company carrying out construction work for its clients. Given the wide variety of activities that qualify as construction operations (defined in Finance Act 2004 s 74), many individuals and organisations may fall within the scope of the CIS without realising it.

Examples of parties who may unexpectedly be treated as subcontractors include:

- a tenant in a commercial building who receives payments from their landlord for construction work which is not exempt under Regulations 20 or 20A of the Income Tax (Construction Industry Scheme) Regulations 2005;
- a self-employed project manager who is closely involved in the execution and supervision of a property development project, to the extent that they are contractually answerable for construction work carried out by others;
- a labour agency supplying construction workers under a contract between the agency and the contractor;
- a loss adjustor engaged by an insurance company to arrange construction operations on behalf of the insurance company;
- a traffic management services provider whose work forms an integral part of a wider construction project; and
- a development company within a corporate group that undertakes construction work for a related property investment company. The fact that the companies are in the same corporate group does not stop the development company from being treated as a subcontractor under CIS.

It is important to note that the contract cannot be an actual or deemed employment contract (for example, under Chapter 10 of Income Tax (Earnings and Pensions) Act 2003). Where such an employment relationship exists, the CIS rules do not apply.

Subcontractors based overseas

The CIS applies to construction operations carried out within the UK, including within its territorial waters (which extend to 12 nautical miles from the high watermark).

A key point is that if a single contract between a contractor and subcontractor involves work both inside and outside UK territorial waters, HMRC treats the entire contract as falling within the CIS. For example, if a specialist company is engaged to lay powerlines from an offshore wind farm located beyond UK territorial waters to an onshore terminal under a single contract, the whole contract is treated as under the CIS because part of the work takes place inside UK territorial waters.

It is the location of the construction operations, not the location or tax residence of the subcontract, that determines whether the CIS applies. Therefore, if any part of the work is performed within the UK or its territorial waters, the subcontractor is within the scope of the CIS, even if they are based overseas.

In the example above, an overseas contractor with no UK tax presence would still be caught by the CIS. It should therefore consider registering with HMRC as a subcontractor to avoid unnecessary tax deductions. Failure to register could result in a CIS tax deduction of 30% on payments received from the contractor.

Are all subcontractors subject to CIS tax deductions?

No – not all subcontractors are subject to the same level of CIS tax deductions. Under the CIS, subcontractors fall within one of three payment status categories.

Unregistered subcontractors: The contractor must deduct CIS tax at 30% from payments to the subcontractor, which is the default rate applied when a subcontractor is not registered with HMRC.

Registered for net payment status: As above, except that payments are subject to a reduced CIS tax deduction rate of 20%.

Registered for gross payment status (GPS): Subcontractors in this category enjoy full payments with no CIS tax deductions, provided they meet HMRC’s criteria and maintain compliance (see more on this below).

Note that a subcontractor’s payment status can change over time. A business initially registered under the 20% net deduction rate may later be approved for GPS once it satisfies HMRC’s requirements.

Subcontractors without GPS must be given evidence of the CIS deductions made by the contractor. The contractor is required to provide a ‘payment and deduction

statement’ within 14 days of the end of the tax month. This document serves as proof of the tax deduction and is needed for the subcontractor’s own tax records and filings.

Limited company subcontractors

Limited company subcontractors can reclaim CIS deductions suffered by offsetting them against their employer liabilities, including:

- PAYE tax deducted from employees and directors;
- employer and employee National Insurance contributions;
- student loan repayments; and
- CIS deductions made by the limited company from payments to its own subcontractors.

Each month (or quarter, if applicable), the limited company subcontractor can reduce the total employer liabilities owed by the amount of CIS tax already deducted from its income. This offset is reported through the company’s Employer Payment Summary submitted to HMRC.

If the CIS deductions suffered are greater than the employer liabilities in any given period, the company can:

- carry the excess forward to offset against future employer liabilities within the same tax year; and
- once the final Full Payment Submission and Employer Payment Summary have been submitted at year-end, any remaining excess may be refunded by HMRC or set against the company’s corporation tax bill.

In-year refunds or set-offs against other taxes (outside of employer liabilities) are not normally allowed by HMRC. In our experience, refunds and set-offs against other liabilities can take several months for HMRC to process, especially for overseas subcontractors.

Accuracy is very important when making these claims. HMRC may review offsets against employer liabilities and, if they find errors or suspect inaccuracies, can request amendments to the EPS or supporting evidence. If the subcontractor fails to respond with clarifying information within the set timeframe, HMRC may correct the

offset claim and suspend further CIS offsets for the rest of the tax year. Where HMRC issues such a decision, the limited company subcontractors can appeal if they believe the decision has been made in error.

Subcontractors that are not limited companies

Subcontractors who are individuals or partnerships should claim any CIS tax deductions suffered on their annual Self Assessment tax return, rather than offsetting them monthly or quarterly as limited companies do. The deductions are offset against their overall income tax liability for the year.

Why is having GPS beneficial?

Obtaining GPS can be hugely valuable for subcontractors, offering benefits in three main areas.

1. **Improved cash flow:** With GPS, contractors pay subcontractors in full without deducting CIS tax. This means that more cash stays within the business, allowing subcontractors to pay wages, purchase materials or reinvest in equipment without waiting to reclaim deducted tax.
2. **Enhanced credibility:** Being approved for GPS demonstrates to contractors, clients and lenders that the subcontractor is financially responsible and tax compliant. It can build trust and may make the subcontractor a preferred subcontractor, as GPS-approved businesses will present the contractor with less CIS risk and reduced administration.
3. **Simplified administration:** Subcontractors with GPS avoid the ongoing task of tracking, reconciling and reclaiming CIS deductions. This streamlines their accounting processes and reduces the administrative burden associated with CIS compliance.

How to register as a subcontractor

Registration by individuals, businesses and organisations can be completed online via HMRC’s CIS portal or, where online registration is not possible, by post. For non-UK limited company subcontractors a different registration process is applied, requiring supporting information.

Where a subcontractor is applying for GPS, they must also provide documentation supporting the evidence and turnover tests. Failure to provide complete and accurate information at the outset can result in the application being rejected by HMRC.

How to obtain gross payment status

To obtain GPS, the subcontractor must apply to HMRC and satisfy three key tests: a business test; a compliance test; and a turnover test.

Business test

To meet the business test, the subcontractor must be carrying on a genuine business in the UK and must operate through a bank account. This demonstrates an established and traceable business presence.

Compliance test

To meet the compliance test, the subcontractor’s tax affairs must be up to date for the 12 months prior to application, although there are some compliance failures which HMRC may overlook. HMRC can also refuse GPS if it has strong grounds for doubting the applicant’s future compliance. For UK-based subcontractors, HMRC will check the subcontractor’s compliance directly. Non-UK subcontractors must obtain and submit a certificate from their home country’s tax authority confirming that they are tax compliant.

Turnover test

The turnover test varies depending on whether the applicant is an individual, partnership or company. Note that a company wholly owned by a parent company that already holds GPS does not need to pass the turnover test. The turnover tests are summarised below.

1. Standard test

For the 12 month period prior to application:

- **Individuals:** must have net construction turnover of at least £30,000.
- **Partnership:** must have net construction turnover of at least £30,000 per individual partner, plus £30,000 per 'relevant person' associated with any company members.
- **Companies:** must have net construction turnover of at least £30,000 per relevant persons.

Net construction turnover is the gross construction turnover after deducting related material costs. *Relevant persons* are a company's directors and, if the company is 'close', its beneficial shareholders.

2. Alternative test

The alternative test is open to partnerships and companies which can demonstrate net construction turnover of £100,000 or more in the 12 months preceding the date of application. This test can be useful for partnerships and companies with many partners and beneficial shareholders, where a higher standard turnover threshold would need to be satisfied.

3. Inherited receipts test

This test can be considered when there has been a change in the type of business concern in the previous 12 months, such as an individual sole trader incorporating as a company, or several sole traders forming a partnership. The new concern may have insufficient net construction turnover to register for GPS, but the inherited receipts test helpfully allows turnover from the previous concern during the qualifying period to be included in its GPS application.

4. Transferred receipts test

This test can apply when an existing business is sold as a going concern – for example, during a group reorganisation – to a new owner (usually a business) which doesn't hold GPS. When applying for GPS, the new owner may include turnover earned by the business while in the hands of the previous owner during the qualifying period. Importantly, the old owner must also have been able to pass the compliance test at the date of transfer.

5. Prospective receipts test

This is available for a company or partnership (but not a sole trader) that can show it has received at least £30,000 in relevant payments earned on their own account; and entered into construction contracts (with a contractor) where the aggregate value exceeds £100,000.

6. Incidental receipts test

This test is for an application from a sole trader, company or partnership where construction work is not the main activity but which may be incidentally affected by the CIS. To qualify:

- The business's total general turnover (not its net construction turnover, which may be small) in the 12 months before application must meet the standard or alternative turnover threshold for its category.
- The applicant must also show that, in the following year, it is **likely to receive payments** for construction operations incidental to its main business.

Supporting evidence for the turnover tests

When applying for GPS, subcontractors must provide documentary evidence to demonstrate that they meet the relevant turnover test. Suitable evidence might include invoices, payment and deduction statements, and bank statements showing corresponding receipts. However, the exact evidence required will depend on which turnover test is being used. For example, on a recent application using the prospective receipts test, HMRC required:

- a subcontractor invoice showing at least £30,000 invoiced for construction operations;
- proof of payments, such as a bank statement extract, proving that the contractor paid that invoiced amount;
- the payment and deduction statement provided by the contractor;
- a copy of the written contract(s) between the subcontractor and contractor(s). These must clearly show the expected value of the construction operations being undertaken. If the contract does not include these details – or if shows only a single total figure that includes other costs, such as professional fees – HMRC may reject the application.

Providing the correct supporting evidence is key. GPS applications are taking an increasingly long time for HMRC to process, and any problems with the evidence to support the application will (at best) cause further delays. If HMRC refuses a GPS application, it must notify the subcontractor of the decision in writing, explain the decision and the reasons for refusal. If there are grounds, the subcontractor can appeal the decision.

The loss of GPS

Once a business has been granted GPS, HMRC conducts an annual compliance review to ensure that the subcontractor continues to meet the required standards. The same compliance tests and compliance tolerances applied during the initial application process are used for these ongoing checks.

If HMRC identifies tax compliance failures that exceed the permitted tolerances, it will notify the subcontractor that their GPS will be removed, and that 90 days after the date of the notice their payment status will revert to the standard 20% CIS deduction rate.

HMRC will also notify any contractors who have paid or verified that subcontractor within the last two years of the change in status. Subcontractors have the right to appeal HMRC’s decision if they believe there is a reasonable excuse for the non-compliance identified. Subcontractors must ensure they appeal on a timely basis.

The VAT domestic reverse charge (DRC) for construction

Businesses that make or receive payments that are reportable under the CIS must also consider the VAT DRC rules. Whilst there is overlap with the CIS, the DRC is an anti-fraud measure that changes the way VAT is accounted for on certain building and construction services.

Where the DRC applies, the customer (contractor) receiving the services, rather than the supplier (subcontractor), is responsible for accounting for the VAT directly to HMRC. The contractor declares both output VAT and any recoverable input VAT on their VAT return, while the supplier issues an invoice showing that the reverse charge applies and no VAT is charged.

The DRC applies to supplies of building and construction services (referred to as ‘specified services’), where:

- the services are supplied at the standard or reduced rate of VAT (not zero-rated);
- both the supplier and the customer are VAT registered (or are required to be) in the UK;
- payment for the services is required to be reported under the CIS; and
- the customer has not provided written confirmation that they are an end user or an intermediary supplier.

End-user: This is a business that is (or required to be) registered for VAT and CIS and does not make onward supplies of the building and construction services it receives.

Intermediary supplier: This is a business that is (or required to be) registered for VAT and CIS and is connected with an end user (for example, a business that is in the same corporate group as the end user, or landlords and tenants sharing an interest in the same property).

If non-specified services or goods are supplied as part of a single supply that includes specified services, the DRC will apply to the full value of the supply. For example, if a bricklayer supplies both materials and labour, the DRC applies to the full value – even though the supply of materials alone would be outside the DRC.

There is an optional 5% disregard rule for mixed supplies where the reverse charge element does not exceed 5% of the total value of the supply. This allows VAT to be charged in the normal way on the whole supply. However, we rarely see this operated in practice.

Impact of the DRC

The DRC can create cash flow challenges, particularly for subcontractors who previously relied on VAT collected from customers as a short-term source of working capital before paying it to HMRC. Under the DRC, this VAT is no longer collected by the subcontractor, which can reduce cash reserves and make liquidity management more challenging.

Subcontractors may also move into a repayment position on their VAT returns, as they are no longer charging output VAT on supplies eligible for DRC but continue to incur input VAT on their own costs. In such cases, switching to monthly VAT returns can accelerate refunds, though the administrative burden should be weighed against the cash flow benefit.

We also often see examples where the DRC has not been correctly applied in a supply chain. This can expose businesses to interest or penalties where they have recovered VAT on purchases of construction services that should have been subject to the DRC. Businesses working in construction – whether as suppliers or customers – should carefully assess the impact of the DRC by considering:

- how the DRC rules apply to the specific supplies they make or receive;
- the effect on invoicing and accounting processes; and
- the potential impact on cashflow.

In conclusion

Understanding the scope and requirements of the DRC is essential for any business operating in or connected to the UK construction sector. By registering correctly, maintaining compliance, and managing VAT and payment status carefully, subcontractors can protect cash flow and operate more efficiently.

© Getty images