

**EXPLANATORY MEMORANDUM TO
THE FINANCE ACT 2004, SECTION 61(2), (RELEVANT PERCENTAGE)
ORDER 2007**

2007 No. 46

- 1.** This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty.

2. Description

This Order sets the rates of deduction to be made from payments to sub-contractors in the construction industry, as required by Section 61, Finance Act 2004. The rate is 20% for those sub-contractors registered with HM Revenue & Customs for payment under deduction and 30% for those sub-contractors not so registered.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Background

4.1 Part 3, Chapter 3, of Finance Act 2004 establishes a new construction industry scheme, which takes effect from 6 April 2007 (see SI 2006 No 3240). Under Section 61, Finance Act 2004, any person making a payment to a sub-contractor under a contract payment, as defined in Section 60, Finance Act 2004, is required to deduct a sum equal to the relevant percentage from so much of the payment as is not shown to represent the direct cost of materials.

4.2 Under Section 61(2), Finance Act 2004, the relevant percentage means such percentage as HM Treasury may by order determine. Under Section 61(3), the relevant percentage may not exceed the basic rate of income tax for the year of assessment in which the payment is made where the sub-contractor is registered with HM Revenue & Customs for payment under deduction or the higher rate of income tax where the sub-contractor is not so registered with HM Revenue & Customs.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 There has been a special scheme for the construction industry since the 1970s. Contractors making payments to sub-contractors are required to make a deduction from those payments, unless the sub-contractor has met certain requirements in the legislation which allow him to be paid without deduction. The amounts deducted are then set against the sub-contractor's ultimate liability to income tax and class 4 national insurance contributions for the year of assessment. In the case of companies, the deductions can be set against their liabilities as an employer or contractor.

7.2 Under the new scheme, there will be two rates of deduction depending on whether the sub-contractor is registered with HM Revenue & Customs for payment under deduction or is not registered with HM Revenue & Customs. There is no formula for setting the standard rate of deduction other than that it cannot be more than the basic rate of tax. The rate is therefore set at a level which deducts roughly the amount needed to satisfy most sub-contractors' liability to tax and national insurance for the year, taking account of personal allowances. The higher rate deduction has been set at a level which protects the Exchequer as regards payments being made to sub-contractors not known to HM Revenue & Customs and which provides an incentive to those sub-contractors to become registered.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies

8.2 There is no impact on the public sector.

9. Contact

Ray Bourley at HM Revenue & Customs, Tel: 020 7438 7682 or e-mail: ray.bourley@hmrc.gsi.gov.uk can answer any queries regarding the instrument.