

Relevant Contracts Tax - Recent Developments



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INTRODUCTION

Relevant contracts tax (RCT) applies to certain payments to sub-contractors in the construction, forestry and meat processing industries. In recent years, the Revenue have enforced the RCT legislation vigorously and have imposed interest and penalties even in situations where there is no loss of tax. It is therefore of the utmost importance that taxpayers affected strictly adhere to the RCT rules.

APPLICATION OF RCT

All payments made by a principal contractor to a sub-contractor in relation to a relevant contract in the construction, forestry and meat processing industries fall within the scope of RCT. Most commonly the RCT issues arise in the context of the construction industry. This information leaflet accordingly focuses on the RCT regime as it affects the construction industry.

WHAT IS A PRINCIPAL CONTRACTOR?

A person carrying on a business which includes the erection of buildings, or the development of land is regarded as a principal contractor. This includes property developers and those carrying on a building contracting business. Any person connected with a person carrying on such businesses is also regarded as a principal contractor. Therefore where the owners of a property development or construction company or their family members engage sub-contractors to carry out construction work or repairs on their personal property, they should be mindful that the RCT rules apply to them even if they are not personally involved in the property development or construction business.

HOW THE RCT REGIME OPERATES

Under the RCT regime, a principal contractor is required to deduct tax at the rate of 35% from all payments made to sub-contractors unless certain administrative procedures are adhered to. RCT is essentially a prepayment of income tax or corporation tax as the relevant sub-contractor should be entitled to reclaim or seek credit for the RCT deducted through the relevant income or corporation tax return for that year. As the RCT is operated on sales rather than profit, it generally creates cashflow problems for the sub-contractor.



It is possible to avoid the operation of RCT where certain administrative procedures are followed. Such procedures have been highlighted below.

EXCLUSIONS FROM RCT

There are certain exclusions from the RCT regime. For example, where a person developed a property for their own use or occupation, this person would not come within the scope of the RCT regime. Similarly this exclusion applies where the building is to be occupied or used by the employees of the developer.

This exclusion was also concessionally extended by the Revenue to those who constructed a property to hold as a long term investment.

THE REVENUE ISSUED GUIDANCE TO CLARIFY THE INTENDED SCOPE OF THESE EXCLUSIONS AND SUCH EXCLUSIONS WERE LIMITED TO THE FOLLOWING SCENARIOS:

-  A person who is developing a property for letting under a lease of less than 35 years provided they are not connected to an individual or company in the construction industry and
-  A person who is developing a property for occupation by them or their employees provided they are not connected to an individual or company in the construction industry.

The Finance Act 2008 modified the RCT legislation to exclude certain individuals who only came within the scope of RCT by virtue of their connection with meat processing or forestry businesses. Revenue has also recently issued new guidelines in Tax Briefing No. 71 (issued April 2009) which further extend exclusions introduced in the Finance Act 2008 in certain limited circumstances for relevant contracts entered into on or after 20 April 2009. These have been set out below:

1. Individuals or companies connected with companies in the meat processing or forestry business will not be regarded as principal contractors when engaging sub-contractors to carry out minor repair or improvement work on their investment properties.
2. Companies connected to construction or property development businesses will also not be regarded as principal contractors when engaging sub-contractors to carry out minor repair or improvement work on their investment properties.
3. Minor repair or improvement work carried out in a private capacity on private residences or private investment properties by an individual with a controlling interest in a construction or property development company will not come within the RCT regime.

The Revenue has imposed a monetary limit in order to qualify for the above treatment which has been set at €20,000 inclusive of VAT. This limit is operated on a property per property basis. To the extent that additional repair or improvement work is incurred over and above this threshold, normal RCT will need to be operated from that point onwards. Furthermore where a contract is awarded in any tax year and it is known that the total value of the contract will exceed the €20,000 threshold, this contract will be subject to RCT in the normal way.

The guidelines specifically state that it will not be possible to split contracts in order to avoid RCT as the Revenue has expressly stated that this would invalidate the application of the new approach set out above. It is also assumed for the purpose of qualifying for the RCT exclusion that in determining whether an individual has a controlling interest in a construction company that this controlling interest can be determined through the aggregation of shareholdings held by family members or other connected persons in line with the existing RCT legislation.

Revenue have also stated that the new approach which has been outlined above will apply in the case of a building contractor operating as a sole trader or in partnership where the work is in the nature of minor repairs or improvements that have been carried out in a private capacity on their own home or private lettings or other incidental private works. This treatment is also subject to the proviso that the total value of contracts in respect of such work does not exceed €20,000 including VAT in respect of any one property in a tax year.

ADMINISTRATION OF RCT

Registration

A principal contractor is required to register with the Revenue for RCT upon becoming a principal contractor. Whether a principal contractor is required to operate RCT will depend on the tax status of the sub-contractor to whom any payments are to be made.

Deduction of RCT

A principal contractor will be required to deduct RCT at 35% from any payments made to the sub-contractor if the sub-contractor does not possess a Certificate of Authorisation ("C2"). The RCT deducted should then be remitted to the Revenue authorities. An individual, partnership or company should qualify for a C2 if they are tax compliant.

Revenue may refuse to issue a C2 to a sub-contractor where a person connected to the applicant is not considered to be tax compliant. In addition, Revenue may take into account an applicant's likely future tax compliance in order to determine whether a C2 should be issued.

If the sub-contractor is in possession of a C2, the principal contractor should request sight of the sub-contractor's C2. The principal contractor is then obliged to apply to the Revenue for a relevant payments card for that particular sub-contractor. Only on receipt of the relevant payments card can the principal contractor then make payments to the sub-contractor without deducting RCT at 35%. If the principal contractor makes payments to the sub-contractor prior to receiving the relevant payments card, RCT at 35% should be withheld even if the sub-contractor has a valid C2. Failure to do so will make the principal contractor liable for the RCT that should have been deducted together with interest and penalties.

LIMIT IMPOSED ON THE RELEVANT PAYMENTS CARD

Revenue can impose a limit on the gross payments which may be made to any one sub-contractor with a C2. When a relevant payments card is issued for a particular sub-contractor, the principal contractor should review the card and determine if the limit is appropriate. If, for example, a limit of €100,000 is imposed, this means that a principal contractor can only make total payments on an annual basis to this sub-contractor up to that limit of €100,000. If the payments made by the principal contractor exceed this amount then the principal contractor should withhold RCT at 35% on any amount in excess of €100,000. In practice, Revenue may agree to increase the limit at the point it is likely that the original limit will be exceeded.

RCT at 35% should be deducted from payments to sub-contractors in relevant industries where:

- 1. The sub-contractor does not have a valid C2**
- 2. The sub-contractor has a valid C2 but a relevant payments card has not been received**
- 3. A relevant payments card has been received but the limit on the card has been exceeded**

NEW SYSTEM FOR ACCOUNTING FOR VAT

A new system of accounting for VAT was introduced from 1st September 2008 in respect of construction services carried out between principal contractors and sub-contractors. The new system provides a reverse charge mechanism for VAT on the supplies made by sub-contractors to principal contractors involved in construction operations to which RCT applies.

The reverse charge rules will only apply to construction services that come within the RCT regime. It will not however extend to those sub-contractors providing haulage for hire to a principal contractor. RCT will be deducted from the VAT exclusive payment to be made to a sub-contractor in respect of construction operations. Previously RCT was deducted from the VAT inclusive payment.

SUMMARY

It is important that anyone operating in the construction, forestry or meat processing industries ensures that they are fully compliant with their RCT requirements. In particular;

- ✓ All individuals and companies which are engaging sub-contractors should consider whether they are regarded as a principal contractor for the purpose of the legislation.
- ✓ Principal contractors should ensure that a relevant payments card is obtained before any payments are made to a sub-contractor in possession of a C2.
- ✓ Principal contractors should ensure that any limit imposed by relevant payments card has not been exceeded.

This document is intended as a general guide to recent developments in the area of Relevant Contracts Tax. It is not intended to be a comprehensive guide to every aspect of Relevant Contracts Tax. While every care and attention has been taken to ensure the accuracy of the information contained in this document no action should be taken on the basis of the above without obtaining professional taxation advice.

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