



Relevant Contracts Tax (RCT) Update

June 2008

Does RCT apply to your organisation?

If you think not, are you sure?

Relevant Contracts Tax (RCT) is a withholding tax on payments to contractors and has been around for many years. While the common perception is that it is of relevance only to the construction, meat or wood processing industries, a broad range of businesses have found, and in most cases to their cost, that they should have withheld RCT from payments to contractors. RCT does not apply in every case but care needs to be taken to see if the elements for a charge to RCT are present and this must be done before a payment is made.

Recent legislative changes and Revenue practice have strengthened the provisions for applying RCT in cases where businesses incurring expenditure on construction work unwittingly fail to withhold RCT from payments to subcontractors. Revenue have also amended the definition of Principal Contractor to include any company/person who develops land in any way, so any person making payments for a broad range of operations may now come within the scope of RCT.

Examples of the operation of RCT in various industries:

Manufacturing company

Take a company that manufactures products to be used in construction operations. For example; door frames, insulation. Although the company is not directly involved in construction work, it is deemed to be a Principal Contractor on the basis that it manufactures materials to be used in construction operations. Therefore, it is required to operate the RCT procedures in respect of payments to subcontractors for relevant operations.

Supermarket

A supermarket would not be a Principal Contractor under normal circumstances. However, it could be caught in an RCT chain unintentionally. For example, take a supermarket that leases a retail unit from a property developer and under the terms of the lease agreement, the supermarket is required to install a new air conditioning and ventilation system in the unit. RCT obligations could arise for the supermarket in respect of payments to the subcontractor engaged to install the system.

Sale and leaseback arrangements

Take a communications company. If the company decided for financial reasons to erect a new premises and then sell the building on completion to a third party with the intention of leasing it back for the purpose of its business, then the sale and leaseback arrangement could render the telecommunications company to be a Principal Contractor in respect of the construction work undertaken.

Land development

Take a company that develops land but fails to operate the correct RCT procedures in respect of payments for relevant operations. The cost of non-compliance will be significant in terms of Revenue's new code of practice for Revenue audits. For example, if the company pays approximately €500k gross (VAT inclusive) to an unregistered haulier over a two year period to transport materials and machinery to site, it will suffer an RCT liability of €175k plus interest and penalties of approx €59k (assuming full co-operation and a voluntary disclosure is made). If a



full disclosure is not made to Revenue, then perhaps a more costly lesson will be learned if publication as a tax defaulter results!

The above are just a few examples of transactions that can have unintended RCT obligations for companies with no connection to the construction industry.

What are the costs of not operating RCT correctly?

RCT is a simple withholding tax regime if the procedures are operated correctly. However, for companies or persons that operate the procedures incorrectly, then the cost can be significant in light of Revenue's new Code of Practice for Revenue Audits and Voluntary Disclosures. At a first glance, the code of practice appears to provide favourable settlement terms but closer examination reveals that the concessions are only available in exceptional circumstances and only in cases where the subcontractor had a valid C2 at the date of payment. This is a case of Revenue adopting a zero tolerance approach in respect of payments paid gross to unregistered subcontractors.

Under the new code of practice, where a Principal Contractor makes a payment gross without deduction of RCT to an unregistered subcontractor, the Principal will be responsible for the payment of the RCT due of 35% together with interest and penalties. In addition, the Principal Contractor cannot issue a Relevant Contracts Tax Deduction Certificate (RCTDC) to allow the RCT to be recovered by the subcontractor. This is a severe penalty and a costly lesson for non-compliant Principal Contractors. Regrettably, ignorance of the RCT provisions is no longer a defence to mitigate RCT, interest or penalties.

A copy of the new RCT code of practice can be downloaded at www.revenue.ie/index.htm?/ebrief/ebrief10_07.htm

What about foreign subcontractors?

The RCT procedures apply once the relevant operations are performed in Ireland. So the tax residence status of the Principal Contractor or the subcontractor is irrelevant.

For example, take a Dutch company which contracts with a UK subcontractor to carry out relevant operations in Ireland. Even if the contract is signed outside Ireland and payment is made outside Ireland, the Dutch company is still required to register as a Principal Contractor and operate the RCT procedures in respect of any payments to the UK company. In addition, following the introduction of PAYE on foreign employments exercised in Ireland from 1 January 2006, Revenue are now also actively reviewing PAYE compliance by foreign contractors whose employees are engaged in relevant operations in Ireland. In many cases, Revenue Audits of PAYE and RCT are the carried out simultaneously by Revenue.

Recent RCT changes

A number of RCT changes were introduced recently in Finance Act 2008, Revenue e-briefs and also the new RCT regulations published by Revenue. These changes are applicable to persons operating in the construction, meat processing and forestry industries:

Connected persons

The "connected persons" rule for RCT purposes is being amended with effect from 13 March 2008 so that it no longer applies to "innocent" incidental connections. The amendment is aimed at persons obliged to operate RCT because they are connected with a company engaged in the business of land development or construction. In future, such persons will not have to operate RCT where they engage a subcontractor solely to carry out work on their own business premises or private dwelling (provided they are not otherwise engaged in the business of land development or construction).

New Declaration Form RCT1

Revenue have introduced a new and more detailed Form RCT1, on which declarations must be made by a Principal Contractor and subcontractor that the contract being entered into is a relevant contract for RCT purposes and not an employment contract.

The new RCT1 form must be used in respect of all new relevant contracts entered into on or after 1 April 2008. In conjunction with the new form, Revenue have re-launched the Code of Practice for Determining Employment or Self-Employment Status of Individuals, which principals and subcontractors are required to read before making the declaration. A copy of the new form RCT1 and the new Code can be downloaded at:

www.revenue.ie/forms/rct1.pdf
www.revenue.ie/leaflets/code-of-practice-on-employment-status.pdf

Delivery of Form RCT1 to Revenue

The Principal Contractor will now also be required to send the RCT1 forms to Revenue within 7 days of the declaration being made in the following circumstances:

- where the relevant contract is the first such contract entered into by the Principal and the subcontractor;
- where the subcontractor's PPS number or tax reference number, VAT registered number or employer registered number, as appropriate, are not entered on Form RCT1;
- where the subcontractor is not registered for all appropriate taxes.

The obligation placed on Principals in this regard is based solely on the information entered on the form by the subcontractor. Therefore, the Principal is not required to independently verify the information.

Exclusion from the RCT1 Process

The new RCT regulations provide that an RCT1 declaration does not need to be completed by a Principal and subcontractor, in cases where a subcontractor has applied for (on Form RCT1-E) and has been issued with a "notice of exclusion" from Revenue. To obtain a notice of exclusion, a subcontractor's annual average sales from relevant operations in the three years prior to application must have exceeded €6,340,000. Once obtained, this notice will be valid for a period of three years unless cancelled by Revenue.

VAT – new reverse charge regime for construction sector

A new reverse charge regime will apply within the construction sector from 1 September 2008 whereby sub-contractors will no longer be required to levy VAT on their services. Instead, the principal contractor will be required to self-account for the VAT arising. This measure should provide cash flow relief for sub-contractors but will increase the reporting obligations for principal contractors. The measure will impact non-Irish sub-contractors in particular as such contractors will no longer be obliged to register for VAT in Ireland in respect of these services.

Summary

As the costs of not operating the correct RCT procedures are severe, organisations should routinely consider the potential RCT implications before undertaking any property or development related activity. Advice should be sought at an early stage if there is any doubt as to your organisation's RCT obligations.

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