RCT – Common misperceptions and consequences of non-compliance

By Janette Maxwell and Jarlath O'Keefe

Janette and Jarlath consider potential pitfalls in the current RCT regime and how to avoid them.

As you will no doubt be aware, compliance risks in the construction sector are currently a key focus of Revenue. Given the increased Revenue activity in this area of late, it is opportune to consider how best to avoid the common tax pitfalls in this sector. One area which continues to cause complexities is in the area of Relevant Contracts Tax (RCT). The emphasis in this article is on the aspects of RCT which have been identified as creating costly mistakes for the unwary, and we have deliberately not delved into the minutiae of the operation of RCT.

Overview of Payment Notification and Deduction Summary

The first potential pitfall to be examined when dealing with the RCT regime is perhaps the easiest of all to avoid. The most important rule of thumb for a principal contractor (principal) can be summarised in one short statement – *when a principal wishes to make a payment to a sub-contractor, it is imperative that the principal does not make a payment before notifying Revenue.* Fortunately, the eRCT system has made this process relatively efficient and straight-forward, yet a significant number of principals still make payments to sub-contractors before informing Revenue of the assignment in question.

When the penal consequences of a failure to comply are considered, the importance of ensuring that the principal notifies Revenue of its intention to make such a payment cannot be overstated. In addition, it is a common misconception that if a payment for similar work was notified to Revenue in the past, a separate Payment Notification does not need to be submitted. This is incorrect and a new Payment Notification ***must*** be submitted to Revenue for every payment to be made to a sub-contractor.

When a Payment Notification has been made, a Deduction Authorisation will be issued to the principal's ROS inbox which clearly shows the applicable RCT deduction rate and the amount of RCT to be deducted. If amendments are required to be made to a Deduction Summary after the due date, this will mean that the return is late. As a consequence, a surcharge of €100 will be applied plus the tax due.

Non-Resident Principals

Given the complexities of RCT experienced by resident principals and their advisors, it is unsurprising that many non-resident principals are unaware of their obligations within the RCT regime in Ireland. In brief, if the construction

operations are carried out in Ireland, RCT applies to the transaction. This means that non-resident principals who have subcontracted work which takes place in Ireland are obliged to operate RCT on the payments made to sub-contractors.

One particular reason why so many non-resident principals have fallen into this trap might be because these non-resident principals may not have an obligation to register for other taxes in Ireland. Therefore they have genuinely not considered that they may be obliged to register and operate RCT if the operations are carried out in Ireland.

Interaction between RCT and VAT

Construction services which are subject to RCT are subject to VAT on a reverse charge basis. As a result, the invoice raised by the sub-contractor to the principal should not include VAT on the services provided. Whilst the invoice should include all the information which appears on a VAT invoice, in addition, the document should include the VAT registration number of the principal and the following narrative:

> *"VAT on this supply to be accounted for by the Principal Contractor."*

As a result, when the principal pays the sub-contractor for the services, this payment should not include VAT. If RCT is to be deducted it should be calculated on the VAT-exclusive amount. Of course it is necessary to ensure that the transaction is accurately reflected in the VAT3 as follows:

- VAT on services received from the sub-contractor should be recorded as VAT on Sales – Box T1
- The principal can claim a simultaneous input credit which should be recorded as VAT on Purchases (where entitled to do so) – Box T2

Mini Case Study – Non Resident Principals and Sub-Contractors

The pitfalls encountered by non-resident contractors are best demonstrated by way of the following fictitious example.

Background Facts

Let's assume that Company A (based in Ireland) engaged Company B (based in the UK) to recruit personnel to carry out demolition work on a number of properties in Dublin. Company B in turn engaged Company C to provide the personnel required. In light of these background facts, what are the RCT and VAT obligations arising?

RCT and VAT obligations

Company A is required to operate RCT on the payments made to Company B because Company B has arranged for the labour of others to be furnished to carry out the demolition work on the sites. This brings Company B within the scope of RCT as it is regarded as a sub-contractor carrying out construction operations.

The provision of the services by Company B to Company A falls within a reverse charge provision for the supply of construction services, which are subject to RCT. Therefore Company B does not have any output VAT liability in respect of the provision of the services.

The payments made by Company B to Company C also fall within the RCT regime using the same rationale for the payments made by Company A to Company C. Company B is required to register for Irish VAT purposes as a principal. The provision of the services by Company C to Company B is subject to VAT on a reverse charge basis with Company B accounting for Irish output VAT at 13.5% in its Irish VAT return. Company B has an entitlement to a simultaneous VAT input credit as it has used the services to make taxable supplies to Company A.

Consequences of getting it wrong

From 1 January 2015, a revised scheme of "payment geared" penalties was introduced for principals who fail to correctly operate RCT on payments to sub-contractors. Section 530F of the Taxes Consolidation Act 1997 ("TCA 1997") provides for a penalty where a principal makes a payment to a sub-contractor without having the required Deduction Authorisation as outlined above. The penalty that a principal will be liable for will be proportionate to the amount of the tax that should have been deducted. From 1 January 2015, the penalty for each instance of non-operation of RCT is based on the status of the sub-contractor.

As the table demonstrates, non-compliance in the area of RCT

can potentially be extremely costly for those in default:

Type of Sub-Contractor	Rate of Penalty
Unknown	35%
0%	3%
20%	10%
35%	20%

Since January 2012, the rate applicable to each sub-contractor is determined by their tax compliance history and status:

Status of Sub-Contractor	Rate of RCT
Good compliance record	0%
Registered for RCT as a sub-contractor with a reasonable compliance record	20%
Contractors unknown to Revenue (not RCT registered) or those known for chronic non-compliance.	35%

In addition, section 1052(1) (b) TCA 1997 provides for a fixed penalty of €3,000 for a failure to comply with RCT obligations. Where a body of persons (e.g. a company) is in default, the fixed penalty is €4,000 with the Secretary of that body of persons being liable to a separate fixed penalty of €1,000.

Increased Revenue Activity

On 25 August 2015, Revenue published eBrief No.77/15 which confirmed that taxpayers could expect increased compliance interventions as Revenue heightens its activity in this area following the launch of a new project. This e-brief highlights the need for the proper operation of the RCT system, in particular, by ensuring that principals are fully reporting payments through the eRCT system and principals are reporting "unknown" sub-contractors. As part of this project, Revenue has been reconciling the eRCT system with PAYE/PRSI returns and VAT returns.

Revenue also published eBrief No. 33/16 on 23 March 2016. The purpose of this eBrief was to provide notification that it became apparent to Revenue that VAT was not being applied correctly in cases where construction services fell within the scope of RCT. One particular area of default identified was the failure on the part of the principal to self-account for the VAT. Revenue suggested that they will continue to pay close attention to how VAT is being accounted for on a reverse charge basis. Penalties would of course be applied as appropriate.

In April 2016, Revenue published a leaflet on RCT penalty guidelines entitled "RCT – Penalties for Non-Operation of the RCT system". Whilst the leaflet is informative with regard to the operation of the RCT regime, perhaps the most useful aspect of these guidelines for practitioners is Appendix I which outlines the circumstances whereby RCT penalties may be mitigated. Mitigating factors which are considered by Revenue include co-operation of the taxpayer, the general compliance of the principal, innocent error and the tax at risk.

Conclusion

Those who fall within the scope of RCT must ensure that appropriate procedures are in place to ensure the correct operation of the regime. As alluded to above, the consequences of non-compliance with regard to the RCT regime can be penal. A solid understanding of the RCT regime is therefore necessary.

Regrettably there are no "special rules" for non-resident principals who unknowingly find themselves within the RCT regime. If a non-resident principal subsequently discovers that a project was within the RCT regime, they are relying on the leniency of Revenue to reduce or waive penalties, according to the mitigating factors outlined in Revenue's publication from April 2016.

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