



# Practical Guide for Principal Contractors to Avoid RCT Pitfalls

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## Introduction

Aside from determining when a particular assignment or project is within the scope of Relevant Contracts Tax (RCT), perhaps the most challenging aspect of RCT is the administrative demands its operation places on principal contractors (“principals”). Given the heightened Revenue activity in this area, it is opportune to reconsider this complex tax.

For RCT to apply, a principal must engage a sub-contractor to carry out “relevant operations” under a “relevant contract”. The intricacies of what constitutes relevant operations and relevant contracts are outside the ambit of this article, and the focus here is the onerous obligations placed on those who fall within the scope of a principal.

There are many administrative steps for principals to take to ensure that they are fully compliant when operating RCT on payments to sub-contractors:

- › register for RCT on Revenue's Online Service (ROS),
- › notify Revenue of each contract (Contract Notification),
- › create a Site Identifier Number,
- › notify Revenue of the payment to be made to a sub-contractor (Payment Notification),
- › await issuance of a Deduction Authorisation by Revenue,
- › provide a copy of the Payment Notification Acknowledgement to the sub-contractor and
- › await receipt of the Deduction Summary at the end of each month and carefully review this Summary to ensure accuracy.

More detailed descriptions of these steps follow, with particular emphasis on how to avoid falling foul of the regime.

## Contract Notification

Provided that the principal contractor is already registered for RCT on ROS, when a principal has won the tender for a new project, the first action is to register the contract with Revenue.

The principal is also required to obtain documentary evidence from the sub-contractor. This includes the sub-contractor's name and tax reference number, the estimated contract value and a declaration on employment status (i.e. that the contractor is self-employed and not an employee). For sub-contractors with no Irish tax reference number, additional details consisting of their contact number and email address are required.

Revenue will allocate a contract identification number and will issue an indicative deduction rate that will apply to payments being made to the sub-contractor.

Since January 2012 the rates applicable to sub-contractors are determined by their tax compliance history and status:

- › 0%: registered for RCT as a sub-contractor with a good tax compliance record,
- › 20%: registered for RCT as a sub-contractor with a reasonable compliance record and

- › 35%: unknown to Revenue (not RCT registered) or known for chronic non-compliance.

## Site Identifier Number

In addition, a Site Identifier Number (SIN) will have to be created, which uniquely identifies the project or site where the works will be carried out. The SIN was introduced in December 2015 and is therefore a relatively recent addition to the RCT regime.

As the SIN is a unique system-generated number that is allocated to each site, it should be used in respect of **all** contracts notified on that specific site. This number is created when the principal notifies a contract on ROS, and all sub-contractors will be notified of the SIN in their contract notification letter.

## Payment Notification

When principals wish to make a payment to a sub-contractor, they must notify Revenue of their intention to make such a payment. It is crucial that the principal does not make a payment before notifying Revenue. Even if a payment for similar work was notified to Revenue in the past, a separate Payment Notification must, nonetheless, be submitted for every payment to be made to a sub-contractor.

## Deduction Authorisation

When a Payment Notification has been made, a Deduction Authorisation will be issued to the principal's ROS inbox, clearly showing the applicable RCT deduction rate and the amount of RCT to be deducted. If amendments have 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 any tax due as per the amendments.

## Payment Notification Acknowledgement

The principal must provide a copy of the Payment Notification Acknowledgement to the sub-contractor. This is to enable the sub-contractor to recover the RCT deducted.

## Deduction Summary

The Deduction Summary is received by the principal via ROS at the end of each month. This summarises all payments made to sub-contractors during the filing period in question. The principal should carefully review the Deduction Summary before it is filed with Revenue by the 23<sup>rd</sup> day of the following month (together with any RCT deducted).

Aside from the above practical guide to the operation of RCT, a number of other areas of the regime should be highlighted.

## Non-Resident Principals

The risk for any businesses taking on an assignment in another country is that they have to ensure that they appropriately familiarise themselves with the relevant “rules and regulations” of the country in which they wish to do business. Given the complexities of RCT experienced by resident principals and their advisers, it is no surprise that many non-resident principals are unaware of their obligations under the RCT regime in Ireland.

Essentially, if the relevant operations are carried out in Ireland, RCT applies to the transaction. This means that non-resident principals who have sub-contracted work that takes place in Ireland are obliged to operate RCT.

The consequence of this is that, although non-resident principals and sub-contractors may not have an obligation to register for other taxes in Ireland, they may be obliged to register and operate or suffer RCT if the operations are carried out in Ireland. This is, of course, a pitfall for the unwary.

## Revised Penalties for Failure to Operate RCT Correctly

For 2015 and subsequent years, a revised scheme of penalties has been introduced for principals who fail to operate RCT on payments to sub-contractors. The penalties are evidence that the consequences of non-compliance are significant:

- › 3% penalty: 0% rate sub-contractor,
- › 10% penalty: 20% standard rate sub-contractor,
- › 20% penalty: 35% sub-contractor and
- › 35% penalty: unregistered sub-contractor.

As these penalties are significantly higher than the pre-2015 regime, non-compliance in the area of RCT can be extremely costly for those in default.

## Interaction between RCT and VAT

Another pitfall for principals may be the incorrect operation of VAT on projects falling within the scope of RCT.

Construction services that 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. Although it should present all of the information that also appears on a VAT invoice, the document should include the VAT registration number of the principal and the narrative: “VAT on this supply to be accounted for by the Principal Contractor.”

Therefore, 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.

In addition, the principal should ensure that the transaction is correctly reflected on the VAT 3 return as follows:

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

## Heightened Revenue Activity

One explanation of why RCT has become so topical in recent times is that, over the past 12 months, Revenue has been increasing compliance interventions in the construction sector. A summary of two pertinent eBriefs follows.

### Revenue eBrief No. 77/2015

This eBrief, published on 25 August 2015, confirmed that taxpayers can expect increased compliance interventions as Revenue heightens its activity in this area after the launch of a new project. It was stated that Revenue is likely to reconcile an eRCT system with PAYE/PRSI returns and VAT returns and to examine profit margins.

The eBrief highlighted the need for proper operation of the RCT system, i.e. ensuring that principals are fully reporting payments through the eRCT system and that they are reporting “unknown” sub-contractors.

### Revenue eBrief No. 33/2016

This eBrief was published on 23 March 2016, seven months after Revenue initially highlighted its focus on compliance risks in the construction sector. During the programme of interventions,

it became apparent to Revenue that VAT was not being applied correctly in cases where construction services fell within the scope of RCT. In particular, there was a failure on the part of the principal to self-account for the VAT.

Revenue indicated that it will continue to pay close attention to how VAT is being accounted for on a reverse-charge basis and that, where appropriate, penalties will be applied. Revenue also raised the issue of the reverse-charge VAT paid being omitted from the VAT 3 return.

The eBrief also advised that the “two-thirds” rule has been used in circumstances where construction operations fall within the remit of RCT. This rule is a special rating provision whereby if the VAT-exclusive cost of goods to a supplier exceeds two-thirds of the VAT-exclusive price charged to a customer, the supply is taxable as a supply of goods. For completeness, the “two-thirds” rule should not be applied where construction operations come within the RCT regime.

### RCT Penalty Guidelines

Since the revised penalties for RCT were introduced in January 2015, the general consensus among tax professionals has been that they are unduly harsh in some circumstances. In response to this feedback, in April 2016, Revenue published “RCT Penalty Guidelines”, which clarifies the circumstances in which the penalties for non-operation or incorrect operation of the RCT system may be reduced. The following matters will be taken into account:

- › the tax at risk,
- › the general compliance of the principal,
- › the cooperation of the principal,
- › self-correction by the principal and
- › innocent error.

Revenue indicated that there is no “one size fits all” formula to be applied in determining an appropriate level of mitigation by virtue

of the discretionary powers of mitigation provided for in s1065 TCA 1997. Each case will need to be reviewed individually, taking all of the risks and factors into account. However, where there is a

complete and deliberate failure to operate RCT, Revenue emphasised that mitigation would not be appropriate.

### Conclusion

In conclusion, a number of points are noteworthy for principals:

- › There are severe consequences for non-operation of RCT, with penalties of up to 35%. Therefore a strong understanding of the RCT regime is necessary, and each principal should make sure that appropriate procedures are in place to ensure the correct operation of the regime.
- › There are no “special rules” for non-resident principals who unknowingly find themselves within the RCT regime. Non-resident principals who later discover that a project was within the RCT regime are relying on the leniency of Revenue to reduce or waive penalties.
- › Even if a payment for similar work was notified to Revenue in the past, a separate Payment Notification must be submitted for every payment to be made to a subcontractor. It is critical that this aspect of the regime is adhered to because the principal must wait until the Deduction Authorisation has issued. The Authorisation clearly shows the applicable RCT deduction rate and the amount of RCT to be deducted.

It is evident from the above that the obligations placed on principals by the RCT regime are onerous. Due to the heightened Revenue activity in the area, it is more important than ever for principals to ensure that they have adequate procedures in place to deal with their RCT obligations.

Read more on [taxfind](#) VAT, RCT and construction, Annual Conference 2016, Ivor Feerick; RCT Penalty Regime Guidelines, Irish Tax Institute Bulletin

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