

## Property and Construction *An overview of VAT and RCT*



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Leading business advisors

## VAT and RCT law relating to property and construction projects is a complex and challenging discipline.

VAT on property rules were overhauled over 3 years ago and since then there are essentially two sets of rules; one dealing with property acquired since July 2008 and another dealing with property held on that date. There are also complex rules interlinking VAT and RCT in relation to construction services. Advice should be sought before entering such transactions. The Deloitte Indirect Tax Group has recognised VAT and RCT experts to guide you through the complex issues and to ensure you avoid the many potential pitfalls.

### Value Added Tax

Construction contracts are normally chargeable to VAT at 13.5% but certain fittings can be liable to VAT at 21%. Where RCT applies to a construction contract the purchaser of the service must account for VAT on the reverse charge basis\*.

Depending on the circumstances, the supply/purchase of property may be entirely VAT free, chargeable to VAT at 13.5% or chargeable to VAT at 21%. Furthermore, depending on the nature of the transaction, the vendor may charge VAT or the purchaser may be obliged to account for VAT on the reverse charge basis\*. In cases where a property is chargeable to VAT, the vendor/purchaser, as the case may be, should register for VAT and account for VAT chargeable. VAT will be deductible where the property is used for vatable business purposes.

\*Accounting for VAT on the reverse charge basis means that the supplier does not charge VAT to the purchaser. Rather, the purchaser accounts for the VAT chargeable in his/her VAT return. The recovery of this VAT is dependent on the vatable activities of the purchaser

### The following is a high level summary of the relevant VAT rules:

#### Purchasing a property

If you are charged VAT when purchasing a property, you will be able to claim back that VAT to the extent that you use the property for vatable purposes.

#### Use of a property: The 20 year watch

All properties that you purchase will be subject to what is known as the capital goods scheme. Under the capital goods scheme the VAT recovered initially will be under the microscope for 20 years. In essence, if a property is used for fully vatable purposes for the entire 20 years there will be no VAT issue, whereas if there is subsequent use for VAT exempt or partially

exempt or non-business activities there will be a claw back of a proportion of the VAT recovered based on such use. Alternatively, if a property is initially put to an exempt use and is subsequently used for vatable purposes or partially vatable purposes there will be a proportionate recovery of the irrecoverable VAT paid.

#### Letting a property/exempt with option

Since 1 July 2008 the letting of property under occupational type leases is exempt from VAT. This will have two consequences, being (a) you cannot charge VAT on the rent, and (b) you are not entitled to recover VAT on the cost of purchasing, developing and maintaining the property.

#### Sale of property: VAT on sale of new property/ no VAT on the sale of old property

Since 1 July 2008 you are required to charge VAT on the sale of a new property. You do not charge VAT on the sale of an old property. A property is deemed old if no significant development work has been done to it in the 5 years before you sell it or, in some cases, if it has been occupied for two years or more before sale. If the sale of an old property is exempt, you may have to pay back some of the input VAT originally recovered.

#### Properties on hand on 1 July 2008/ transitional rules

These are quite complex rules. However, in essence, the core of the transitional rules is if you recovered VAT on acquisition then you charge VAT on the sale. Where you did not recover VAT on acquisition, then you do not charge VAT on the sale.

#### Minimising potential VAT costs/planning

Letting is exempt from VAT, with attendant VAT costs. To avoid such a cost a landlord can, in certain circumstances, exercise an option to charge VAT on the rent payable. Furthermore, as outlined, there are many instances where the sale of a property is exempt from VAT. If the sale of a property is exempt, you may have to pay back some of the VAT originally recovered on acquisition. To avoid such a cost you can agree with the purchaser that an otherwise VAT exempt sale is chargeable to VAT under a joint option to tax. If you did not recover all the VAT charged when you bought the property, you can recover some of the disallowed VAT if you sell the property subject to VAT.



## Two important practical issues in relation to VAT are:

### Contract clauses/Special condition 3

It is imperative that appropriate VAT clauses are included in contracts and leases. It is not a case of one size fits all and in many instances a vendor/ landlord and purchaser/tenant will come from very different positions as regards VAT. The standard VAT clause (Special Condition 3 in the Law Society sale contract) is a difficult and complex clause with a number of options. An updated version of this was published in early September 2011. Considerable care should be taken as regards same, whether you are a vendor or a purchaser, and it should be remembered that, as drafted, it is a vendor biased clause.

### Pre-Contract Enquiries

This is a document which has been prepared by the Law Society, containing VAT queries to be raised by a purchaser or a vendor and to which replies should be received prior to signing the contract for the purchase of property. This is vital if the purchaser is to be in a position to consider the VAT implications of a transaction. The document is a useful tool for a vendor in the drafting of an appropriate VAT contract clause. An updated version of this was published in early September 2011.

### Relevant Contracts Tax

RCT is a withholding tax mechanism to ensure those involved in construction and other industries are tax compliant. The legislation obliges a person (principal) to retain tax at 0%, 20% or 35% from the amount payable to contractors/ sub-contractors engaged to carry out relevant operations. Specific pre approval is required from Revenue in relation to each payment to be made to ascertain the amount of tax (if any) to be withheld.

RCT applies where a 'Principal Contractor' engages a sub-contractor to carry out certain services. Broadly speaking a principal contractor may include property developers, building companies and all associated building trades as well as individuals who are connected with these businesses. All Government bodies, local authorities, public utilities, boards and bodies established under statute are deemed to be principal contractors. It also includes all gas, water, electric/hydraulic power, dock, canal and railway undertakings. A person or company is

also deemed to be a principal contractor where they sub-contract all or part of a relevant contract under which they are a sub-contractor for RCT purposes.

Services subject to RCT are extensively defined and Revenue practice is to apply a broad interpretation of these definitions and sometimes it may not be obvious whether a particular contract/project includes services which are within the scope of RCT. Services subject to RCT include:

- Construction services
- Design and build contracts
- Supply and install contracts, e.g. power supply, telecommunications, heat, light, air-con, water supply, alarms, sanitation etc
- Repair, demolition, site preparation and clearance services, including skip hire
- Haulage services, crane hire, scaffolding
- Agency services related to the provision of labour
- Operations which are preparatory to, integral or for rendering complete the exploration, extraction or exploitation of natural resources (minerals, oil, gas)

While RCT is essentially a compliance issue, there is significant risk as tax exposures can be substantial where RCT is not operated correctly - e.g. on a payment of €1 million there is a potential tax liability of €350k (plus interest/ penalties). Significant changes will be effective from 1 January 2012 with all RCT compliance being completed online using the Revenue Online System (ROS)

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