



## Property and Construction

An overview of VAT and RCT

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

VAT on property rules were overhauled almost 9 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 construction and property transactions. The Deloitte Indirect Tax Group has market leading VAT and RCT experts to guide you through many complex issues and to ensure you avoid significant potential pitfalls.

### Value Added Tax

Construction contracts are normally chargeable to VAT at 13.5% but certain fittings can be liable to VAT at 23%. 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%, chargeable to VAT at 23% or may fall within the VAT Transfer of Business (TOB) relief provisions. 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 sale of a property 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 only where the property is used for vat deductible 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 their VAT return. The recovery of this VAT is dependent on the vat deductible 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 vat deductible purposes. TOB relief may also apply which will mean the supply is outside the scope of VAT. The purchase may be exempt but for TOB or vatable but for TOB depending on the VAT history of the property. This will have consequences under the capital goods scheme.

#### Capital Goods Scheme: 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 non deductible or partially non-deductible 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 and previously not recovered. The idea being that recovery of VAT over 20 years will mirror the proportion of use of the property for taxable activity over that period of time.

#### Letting a property

The letting of property under occupational 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. In certain circumstances a landlord can opt to tax a letting. In this case the landlord will charge VAT on the rent and will be entitled to recover VAT on the inputs.

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

The general rule is that you are required to charge VAT on the sale of a new property and not 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 even following fully taxable use of the property, you may have to pay back some of the input VAT originally recovered. TOB relief can also apply to the sale of a property which will mean the supply is outside the scope of VAT. The sale may be either exempt but for TOB or vatable but for TOB depending on the VAT history of the property. This may impact the purchaser's right to deduct VAT on the property.

#### Properties acquired under VAT law applicable before 1 July 2008 transitional rules:

These are quite complex rules. However, in essence, the core of the transitional rules is that if you recovered VAT on acquisition of the property before July 2008 then you charge VAT on the sale. Where you did not recover VAT on acquisition, then you do not charge VAT on the sale. Sales of transitional properties can also fall within the TOB relief provisions. Because of the complexity of these rules we recommend that professional advice is always taken in respect of transitional properties.

#### Minimising potential VAT costs

Letting is exempt from VAT, with attendant VAT costs in lost VAT input deduction. To avoid such costs 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 what is known as a joint option to tax. If you did not recover all the VAT charged when you bought the property, you may be able to 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 or landlord and purchaser or 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 February 2014. Considerable care should be taken as regards same, whether you are a vendor or a purchaser, and it should be taken note of that, as drafted, it is a vendor biased clause.

#### Pre-Contract VAT 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 a 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 or purchaser in the drafting of an appropriate VAT contract clause. An updated version of this document was also published in February 2014.

### Relevant Contracts Tax

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

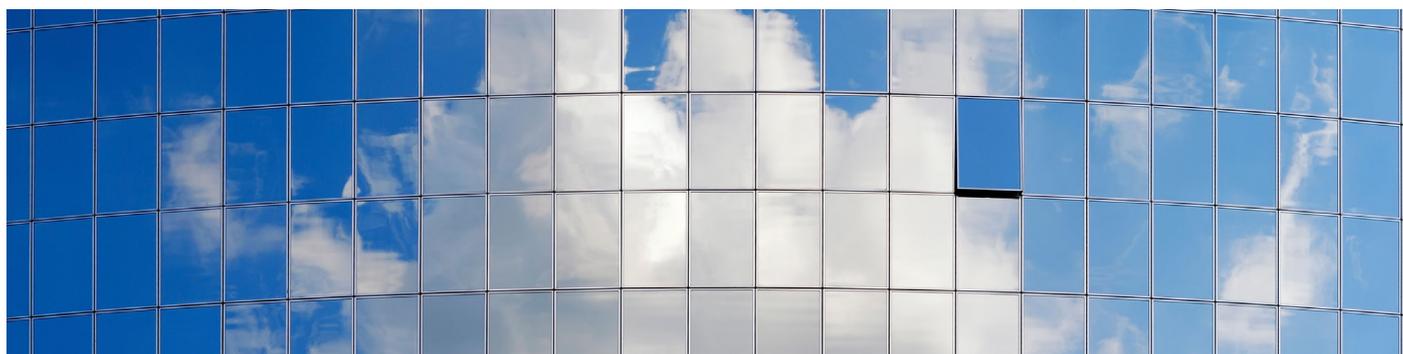
RCT applies where a 'Principal Contractor' engages a sub-contractor to carry out certain services. Broadly speaking a principal contractor may include property developers, building companies and all associated building trades as well as individuals who are connected with these businesses. All Government bodies, local authorities, public utilities, boards and bodies established under statute are deemed to be principal contractors. It also includes all gas, water, electric or 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 or 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 to 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 maximum penalty of €350k, even if the contractor had a 0% deduction rate the penalty may be €30k if RCT formalities are not completed correctly.

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