



# Relevant Contracts Tax Enters the 21st Century



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The Relevant Contracts Tax compliance system is undergoing a complete transformation 40 years since its introduction. The traditional compendium of paper forms, completion of monthly and annual returns and even the familiar “C2 card” or “C2 Authorisation” will all become distant memories. Revenue intends to introduce the new online “eRCT” compliance system with effect from 1 January 2012. There are no changes to the definition of a principal contractor or the definition of “relevant operations”, i.e. the type of activities to which RCT applies. The thrust of the changes is therefore to enhance the tax-avoidance detection capability of the RCT system, as opposed to fundamental changes to the scope of the tax.

This article focuses on the new legislation governing the eRCT compliance system contained in s530A–V Taxes Consolidation Act 1997 and the new RCT Regulations currently at draft stage, which will supersede all previous RCT Regulations. At the time of

writing, both the legislation and the Regulations await a Ministerial Commencement Order.

The key features of the new system are:

- › All principal contractors must engage with Revenue electronically.
- › The standard RCT rate is being reduced from 35% to 20%.
- › C2 Authorisations will cease to exist.
- › Sub-contractors who currently hold a C2 Authorisation will qualify for the zero rate status, provided that their tax affairs are kept up to date.
- › Revenue will automatically credit a sub-contractor with any RCT deducted.

- › Sub-contractors are to receive details of Notified Contracts, Payment Authorisations and notification from Revenue if their deduction rate status changes.
- › There will be no interim RCT repayments; instead, an automatic offset against other taxes will apply.
- › The annual return for RCT is being abolished.
- › New penalties and surcharges will be introduced.

## ROS Registration

From 1 January 2012 all RCT compliance, filing and payments will be conducted online using the Revenue Online Service (ROS). Revenue has indicated that there will be no exceptions to this requirement. Therefore, all principal contractors (and agents) should ensure that they are registered to use the ROS facility as soon as possible. Sub-contractors, although not specifically obliged to for RCT purposes, should also register for ROS in order to access details regarding their RCT transactions.

## eRCT 2012

### RCT deduction rates

The new RCT system will have three deduction rates, and the rate applicable to each sub-contractor will be determined by their tax-compliance history. Sub-contractors who satisfy the current requirements for a C2 Authorisation will have the benefit of a “zero” rate of RCT being applied, i.e. they may continue to receive payments without an RCT deduction. The new standard rate for RCT of 20% will be applicable to registered sub-contractors who may not meet all of the criteria for the zero rate. The 35% rate, currently in use, will remain for sub-contractors who are either not registered with Revenue for RCT or who are registered but have serious tax-compliance issues. Revenue will notify each sub-contractor of the initial rate applicable and if their deduction rate changes.

## eRCT Compliance

### Contract Notification

The first step in the new compliance procedure will be inputting a “Contract Notification”. Revenue has indicated that this part

of the system will be available from 28 November 2011. Revenue will initially pre-populate the Contract Notification details for all principals based on year-end RCT<sub>35</sub> returns for 2010 and payment cards (RCT<sub>47</sub>) that issued to principals for 2011. Principals should review these details, which can be amended, cancelled or updated with information regarding contracts that will be active in 2012. Principals are obliged under s530B(2) and Regulation 4 to ensure that details are input for all new contracts and for existing contracts where payments are outstanding.

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Regulation 4(3) places an onus on a principal to obtain and retain documentary “evidence of identity” from the sub-contractor. Where Revenue is unable to verify the sub-contractor’s identity based on the Contract Notification details, the principal will be obliged under Regulation 4(5) to inform the sub-contractor in writing of this fact within seven days or, if earlier, before making a payment. A principal will not be able to obtain a Deduction Authorisation to make a payment to a sub-contractor without first having completed the Contract Notification stage in respect of the particular contract to which the payment relates.

The eRCT system will issue a Contract Notification acknowledgement to the principal’s ROS inbox confirming the details received; the

sub-contractor will also receive these details. The acknowledgement will indicate the RCT rate applicable to the contractor; however, Regulation 4(6) provides that this is for information purposes only. Each contract has to be notified separately, and a unique reference number will be allocated to each. Multiple contracts with the same sub-contractor all have to be notified; however, the eRCT system will have the facility to upload a number of contracts simultaneously. Regulation 4(7) provides that where the contract value, duration or location changes, the principal must notify Revenue by amending the original Contract Notification with the updated details.

As a result of the Contract Notification, all contractors, especially foreign contractors, should become aware of their Irish tax obligations at an earlier stage. Therefore, the new system should have the effect of encouraging contractors to be more proactive in ensuring

that appropriate tax registrations are in place in order to achieve the standard rate deduction status.

### Payment Notification

A key risk area will be that, before making each payment, a principal must obtain a Deduction Authorisation by inputting a Payment Notification; otherwise, a penalty will apply. A principal is obliged to indicate the amount of an imminent payment due to be made to a specific sub-contractor. Regulation 5(2) requires each payment to be linked to specific contract via the unique reference number allocated at the Contract Notification stage. If a single payment is being made to a contractor in respect of different contracts, Regulation 5(3) requires the payment to be split for Payment Notification purposes and allocated to each unique contract as appropriate.

The eRCT system will not have a facility to allow amendments to a Payment Notification; however, if the details are incorrect, it may be cancelled, and a new Payment Notification should be input. Regulation 5(4) provides that where a principal has input a Payment Notification and anticipates that the payment is not going to be made, the principal should cancel the Payment Notification before the end of the return period.

The requirement on principals to input individual payments into the ROS system is more onerous than the current paper-based system, whereby gross payments are recorded on a payments card (RCT47). Revenue will also have real-time information on cash-flows for both principals and sub-contractors. A principal should also be able to arrange payment clearance for RCT purposes quickly if required, rather than waiting for Revenue to process payment card applications.

### Deduction Authorisation

Once a Payment Notification has been uploaded to the eRCT system, an automatic electronic Deduction Authorisation will issue immediately to the principal. The Deduction Authorisation will show both the principal's and the sub-contractor's tax reference numbers, the rate of RCT applicable to the payment, the gross amount of the payment and the amount of RCT to be deducted, in addition to the date of payment and a unique reference number. The principal is obliged to give a copy – or, at minimum, the details – of the

Deduction Authorisation to the sub-contractor. A sub-contractor will be able to access these details in their own ROS account, where a credit should be shown for the tax amount.

Regulation 6(2) provides that a Deduction Authorisation will be valid until the earlier of:

- › the date on which the principal makes the payment,
- › the due date for the return period in which the Deduction Authorisation issued,
- › the date on which the principal confirms the return for the return period in which the Deduction Authorisation issued or
- › the date of cancellation of the Deduction Authorisation.

Section 530F(2)(a) provides that a principal who makes a payment without first obtaining a Deduction Authorisation will be liable to RCT at 35%, regardless of the status of the sub-contractor to whom

the payment has been made. Section 530F(2)(b) imposes a penalty, in addition to the tax just referred to, of the lesser of €5,000 or the amount of tax due per sub-section (a) unless the details of the payment are included in the return on or before the due date for that period. However, we understand that sub-section (2)(b) is under review by Revenue, and a penalty may apply for every instance of payment being made without a Deduction Authorisation, even when the details are included in the return.

Provided that the details of the payment are contained in the return, the tax amount may be reduced. Revenue will notify the principal of the correct tax deduction rate applicable to the sub-contractor concerned, and an adjustment to the 35% liability may be required. As the sub-contractor has already received the full payment from the principal, no credit for the tax amount will be allowed, i.e. the tax amount will be a real cost for the principal, in addition to any penalty levied.

The penalties referred to above will not apply in the rare instance of a “persistent technology systems failure”, where a principal has no option but to make a payment without having first obtained a Deduction Authorisation. The draft Regulations define this as when the eRCT system is not functioning properly or the principal is experiencing broadband or electricity supply issues. Revenue views

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“persistent” as meaning more than a mere temporary interruption. Regulation 5(5) provides that the penalties will not apply once the principal takes the following remedial steps:

- › Deduct tax from the payment at 35% or in accordance with the latest deduction rate notified to the principal in respect of the sub-contractor concerned.
- › Input details of the payment once the eRCT system can be accessed.
- › Provide Revenue with any details required in respect of the payment – an explanation box can be selected on the Payment Notification screen where details may be input.
- › Remit any tax deducted by the due date for the period in which the payment is notified to Revenue.

A Deduction Authorisation will effectively replace “payment cards”, the main disadvantage being that before each and every payment the details must be input on the eRCT system. This procedure may increase the time spent on ensuring compliance; however, provided that a principal has a robust payment process in place, it should reduce the risk of errors of non-deduction. The benefit for sub-contractors is that an instant credit for tax withheld should be available for offset against other taxes due, rather than their having to submit RCT Deduction Certificates to Revenue.

### Deduction Summary

A pre-populated period-end return will issue to principals, known as a Deduction Summary, which is based on Deduction Authorisations issued during the period. From a risk perspective, it is vital the details are checked. If the principal does not take any action, the Deduction Summary will be deemed to be accepted and the tax thereon will become due. Alterations made to a Deduction Summary after the due date, which is the 23rd day of the month following the period-end, will at minimum incur a €100 surcharge.

A Deduction Summary will display “line items” reflecting each Deduction Authorisation issued, indicating gross amount of payments, tax rates, amounts deducted (if any) and net payments made. If a principal is satisfied that the information accurately

reflects payments made, the Deduction Summary may be accepted; the tax due should be paid via ROS.

A principal can amend the Deduction Summary if the details are not correct. For example, a Payment Notification may have been input but the payment was not actually made by the period return filing date. In this case, the principal is obliged by Regulations 8(3) and 5(4) to cancel the line item on the Deduction Summary. A line item may also be amended where a Payment Notification was made but due to “exceptional circumstances unforeseen” the amount of the payment differs from the original amount notified. In this case, provided that the principal has withheld tax from the full amount of the payment at the rate specified in the Deduction Authorisation, the line item may be amended to reflect the correct details.

There may be instances where a Payment Notification was made and a Deduction Authorisation obtained but the payment was not made in the relevant period but in the next period. Regulation 8(5) provides that the Deduction Summary should be amended to reflect non-payment and allows the Deduction Authorisation to be effectively “carried forward” and become a liability in the next period.

Where a principal accepts the Deduction Summary as a return or is deemed to have made the return and subsequently amends any details thereon after the due date for that period, s530M(2) imposes an automatic surcharge of €100, in addition to the tax due per the amended return. If a payment has been made without a Deduction Authorisation, tax at 35% will be initially due, in addition to a penalty of the same amount capped at a maximum of €5,000, plus interest for the late payment of tax.

Adequate time and resources should be allocated to verifying the details contained in a Deduction Summary, as amendments after the due date incur an automatic surcharge with interest, and the possibility of additional tax and penalties.

### eRCT – Other issues

#### RCT periods

Principal contractors who make annual RCT tax payments to Revenue of less than €28,800 should qualify for a quarterly Deduction Summary period; all other principals will receive a monthly Deduction Summary.

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### Treatment of partnerships/gangs

Where a principal makes a payment to one or more members of a “gang” or partnership, it is to be treated as being made to the individual members in proportion to their respective shares. The authorised gang member or precedent partner must provide Revenue with specific details in order that credit for any tax deducted is allocated appropriately.

### Revenue assessment of tax due

A Revenue officer may raise an assessment under s530N where there is reason to believe that the return made, or deemed to be made, does not reflect the amount of tax due. The provisions of s955, s956 and s1048, including time limits, apply to RCT assessments. An assessment can be appealed to the Appeal Commissioners within 30 days, provided that all RCT returns are up to date and any tax, interest and surcharges thereon have been discharged.

### No interim RCT refunds under new system

Although the standard deduction rate is being reduced to 20%, refunds of RCT will not issue to a sub-contractor during a tax year. Instead, tax withheld will be automatically offset against any other taxes; s530P provides that it should initially be set against preliminary income tax or corporation tax due for the chargeable period. However, we understand that Revenue will allocate the tax credit against fiduciary taxes due before the preliminary tax due date. Only amounts in excess of the final declared and paid income/corporation tax liability for the chargeable period will be available for refund. Revenue will advise sub-contractors when an offset has been implemented, and these details may also be checked on ROS at any stage.

Sub-contractors who have not applied for a refund or offset of RCT deducted from payments under the current system may still apply for a refund or credit for the RCT withheld within the normal four-year limit.

### Proposed transitional arrangements

Sub-contractors in possession of a C2 Authorisation on 31 December 2011 will qualify for the zero rate status when the new system commences on 1 January 2012, provided that they keep their tax affairs up to date. All other sub-contractors will be eligible for the standard 20% rate. Contractors who are new to the RCT system will be at the 35% rate until registered with Revenue. These rates will not change for the first three months of 2012.

Revenue has confirmed that for 2012 only one Contract Notification per sub-contractor engaged will be required. A principal may, however, input the details of each separate contract. From January 2013 a principal will be required to input a separate Contract Notification for every contract with a sub-contractor where it is not a rolling contract, if a tender is required or where any of the engagement terms change.

### Conclusion

The new eRCT system will provide Revenue with significantly more information, in real time, than the current system. Revenue will have greater knowledge pertaining to contracts, overall industry trends and visibility of payments. It is also very likely that foreign contractors will engage with Revenue at an earlier stage. We anticipate an increase in audits and investigations, as Revenue resources are redeployed from processing the current mountain of forms.

From an industry perspective, the online system should provide a quicker alternative to the current paper-based one. Sub-contractors should review their current tax-compliance position to ensure that they will be afforded the best possible rate when the new system goes live. Although the standard rate of deduction is being reduced to 20%, no refunds will issue during a tax year, as any tax deducted will be held by Revenue against other liabilities until after the income/corporation tax returns are filed and paid. This contrasts with the old system, where interim refunds could be obtained if tax affairs were up to date. It remains to be seen whether the efficiencies of the online system, added to the reduction in the standard deduction rate, are enough to negate the cash-flow loss.

As with any compliance system, the information and results produced will depend entirely on the data input. The introduction of the new eRCT system in itself brings a focus on Relevant Contracts Tax compliance issues but also introduces new penalties and surcharges. However, current errors of omission, which account for a significant proportion of RCT exposures – whether it is a case of simply not knowing that you are a principal contractor or which services are subject to RCT – will remain despite the new system.