

**Submission by**  
**The Construction Industry Federation**  
**to the Commission on Taxation**

**May 2008**

**Introduction**

The Commission on Taxation was established in February 2008 at the behest of the Minister for Finance, Brian Cowen T.D. The commission has invited the Construction Industry Federation to make a submission on behalf of its members.

The Construction Industry Federation welcomes the Commission of Taxation and welcomes the opportunity to contribute towards the review of the Irish Taxation system. The main focus of our submission will be directed to issues that affect the industry that we represent. However we also refer to some other issues which affect our members personally as well as the business community as a whole.

Any review of the system of taxation needs to take into account its ability to respond to current economic climates, and contain the flexibility needed to offer support to promote high levels of economic activity on either a regional or sectoral basis. The current economic slowdown is a challenge for the country and necessitates changes, within reason, to sustain economic activity and employment. The current climate also poses an opportunity for whole scale review of the basis on which revenue is collected from individuals and companies. Such a review must, by necessity, include recognition of the changes the ever-larger green agenda will make on the way in which Ireland does business. The suggestions are designed encourage entrepreneurship, promote employment, and assist the construction industry in continuing to adapt to new challenges and opportunities. The recommendations contained in this submission are not exhaustive, but demonstrate the priorities needed as we currently see them.

This submission is composed under two broad headings. The first group of proposals relate directly to the construction industry. The second group of recommendations relates to wider economic, employment, environmental and regulatory issues.

**Construction and property development related***Stamp Duty regulations***Residential**

The changes made in the 2008 Finance Act were broadly welcomed by the industry. However, it is our view those changes do not go far enough. The environmental circumstances in which this submission is made are very different to those in which the Finance Act was drafted.

The main change to residential stamp duty which is now required is, in the case of a person selling a principal private residence (PPR) and purchasing another PPR, that stamp duty would be charged on the difference in price between the two properties. In many cases where a sale of a PPR is contemplated, the Stamp Duty cost is a significant up front cost to be met from personal resources. It is a barrier to personal mobility, particularly when a transaction arises from a change in employment.

The effect of this would be twofold. Firstly, it would make it more affordable for younger families to trade up from their starter home to a larger family home. This is particularly relevant in Dublin and other large centres of population, as residential property Stamp Duty is mainly a tax levied on urban dwellers.

For example, whilst a large number of dwellings were constructed in the greater Dublin area in recent years, the vast majority were apartments which are generally suitable only for single person occupation. Given the current punitive levels of transaction charging, the alternative of a new house is generally not available in most areas in the Dublin area and young families are confined in choice to secondhand properties when trading up.

Secondly, in the case of an elderly person/couple trading down from a large family home to more suitable accommodation in the same area, stamp duty relief should be available. There are a number of social and health advantages for elderly persons contemplating such a move. The decision may be made on the basis that the new property is easier to manage, may be closer to their adult offspring without the strain of moving in with them, or may be closer to facilities such as hospitals, senior citizen clubs, etc. However, the stamp duty cost associated with such a move may prevent that decision being made.

For the individual, it significantly reduces the transaction costs of a move. For the State, any perceived loss in revenue would likely be offset by the revenue from an increased number of transactions. There will also be an increased tax contribution from the ancillary services involved in the process of moving house, renovating costs, etc. For the wider economy, the current stamp duty costs create significant blockages to the proper flow of residential accommodation and result in the poor allocation of public utilities, infrastructure and resources.

The overall fiscal system must have the flexibility to be able to respond to the economic environment of the time. Levels of industry and employment may need, from time to time, specific stimuli on a regional or sectoral basis in order to maintain their activity, which the national fiscal system should be able to implement quickly and effectively.

### **Commercial**

Based on the 'Bacon Report' government introduced a number of changes to income tax and stamp duty. All of those changes were designed to prevent property inflation and it is generally accepted that the attempt was a failure. All the provisions enacted, with one exception, were subsequently repealed. The only one that remains in force is the 9% rate of stamp duty on commercial transactions.

In the current climate, and given average commercial property prices, charging 9% on any consideration over €150,000 is far too high. The government has effectively gained extra taxation on the back of property inflation without adjusting the thresholds on a reasonable basis. The maintenance of the 9% charge has brought Ireland significantly out of line with comparable transaction tax regimes in other economies, which has an impact on the competitiveness of the Irish economy.

Both the stamp duty rates and the rate bands that apply to commercial property should be adjusted to make commercial property a more viable option for investment. Currently an enormous amount of investment funds are leaving the economy to be invested in foreign commercial property where up front transaction costs are significantly lower than in Ireland. A real change in the stamp duty rates and bands will encourage investors to look closer to home when choosing commercial property.

It should not be overlooked that pension fund managers make their investment decisions based on the best return available. Where a pension fund purchases a commercial property in Ireland it is required to pay stamp duty and that reduces the pension fund valuation and the expected return on assets. A form of rebate/exemption of stamp duty for pension funds should be considered. The future of commercial property investment in Ireland looks bleak without some impetus on the taxation front.

***Operation of the Relevant Contracts Tax (RCT) regulations*****Rate of deduction**

Where:

1. a sub-contractor does not submit a Subcontractors Tax Clearance Certificate (C2) to a principal contractor; or,
2. a C2 is submitted but the principal contractor fails to obtain a RCT47 Subcontractors Payments Card; or,
3. the monetary limit on the RCT47 payments card is reached;

the principal contractor is obliged to deduct tax at the rate of 35% on any payment made to that sub-contractor.

The 35% deduction rate was set many years ago when the standard rate of income tax was set at 35% (up to 1988). The steady lowering of the standard rate of income tax since then has not been reflected in the RCT deduction rate. The 35% RCT deduction is applied to the VAT inclusive payment to the sub-contractor. The VAT rate on building sub-contract work is normally 13.5%. The effect of the 35% deduction is that the sub-contractor receives 73.775% of the VAT exclusive amount charged.

RCT deducted in this way may be offset by the sub-contractor, on submission of the appropriate RCT45 certificate, against the sub-contractors liability to other taxes, including VAT and PAYE/PRSI.

The VAT regulations pertaining to sub-contractors will change, with effect from 1<sup>st</sup> September 2008, with the introduction of the reverse charge VAT mechanism. From that date sub-contractors will not charge VAT on the invoices they issue to principal contractors. In this new situation the application of the RCT tax deduction mechanism will mean that the sub-contractor will receive only 65% of the VAT exclusive amount charged. Many sub-contractors fall into the Small and Medium Enterprise (SME) category. This 9% reduction is likely to adversely affect the cash-flow of sub-contractors at a time when the industry is experiencing a period of economic uncertainty and banks are being more cautious in managing their loan and overdraft portfolios.

From September onwards, the average sub-contractor will be in a permanent VAT refund situation and will have less tax against which to offset their RCT deductions. This will impact the sub-contractors unfairly through having to wait for VAT refunds. Additional pressure will be introduced into the Revenue VAT refund processing system by the increase in refund applications and this will generate longer delays in recovering VAT refunds.

In our view the 35% RCT deduction rate should be adjusted downwards to a more realistic rate of 25%.

#### **Simplification of RCT procedures with a view to greater efficiency**

A new format of the Relevant Contracts Tax Declaration form (RCT1) was introduced on 1<sup>st</sup> April 2008. The regulations now stipulate that an RCT1 form should be submitted to the Revenue Commissioners in the following circumstances:

- a. If it is the first time the Principal has entered into a relevant contract with this sub-contractor.
- b. Where the sub-contractor's PPS/Tax Reference Number has not been entered on the form.
- c. Where the subcontractor is not registered for Income Tax or Corporation Tax, as appropriate.
- d. Where the subcontractor is not registered for VAT, or where required, has not provided their VAT Registered Number.
- e. Where the subcontractor will be employing others to carry out all or part of the contract and has not provided an Employer Registered Number.
- f. Where the subcontractor intends to subcontract all or part of the contract and is not registered with the Revenue Commissioners as a Principal.

The process of completing, submitting and processing of these forms first has inbuilt inefficiencies. The system introduced makes no allowance for the fact that, in certain cases, small repair contracts may need to be undertaken as a matter of urgency. In this age of information technology, it should be possible to establish an online tax registration verification

system so that principal contractors can ascertain the information given by a potential sub-contractor is accurate before the RCT1 is submitted.

At present the RCT regulations apply to all payments made to sub-contractors, no matter how small those payments may be. Consideration should be given to introducing a de-minimus rule, so as to eliminate some of the volume from the RCT processing system within Revenue. We would like to see a proposal that, where a sub-contract will involve a payment of less than €2,500 in any two month period, the payment of a lesser sum would be outside the scope of the RCT regulations. This would improve efficiencies both within Revenue and in the wider business community.

#### **Penalties for breaches of RCT regulations**

The penalties for individual breaches of the RCT regulations bear no relation to the tax potentially foregone. The current penalty for a breach of the regulations, where it is clear there is no loss of revenue for the Revenue Commissioners, amounts to €1,265 per breach, whether the amount of tax involved is €100 or €100,000. Whilst the Revenue appear to have some discretion in applying the penalty it appears unfair that taxpayers who are generally regarded as compliant may be exposed to penalties for isolated lapses in their RCT management procedures.

#### **Delays in handling of RCT5 applications and issuance of C2 certificates**

Historically, the processing of C2 applications by Revenue has been painfully slow. The system does not recognise the commercial pressures under which most principal contractors and sub-contractors operate. The security aspect of creating the laminated identity card in particular appears to delay the process. Given that a C2 must be available before a RCT46 application for a payments card can be submitted, which itself can take up to two weeks, there is a need to review the efficiency of this system and improve it.

**Corporation Tax/Income Tax – promotion of energy efficiency****Residential property**

A significant proportion of the country's housing stock was constructed either before the local government building regulations were introduced or when energy efficiency was not a priority. New regulations to be introduced with regard to energy rating of homes will place a large number of homeowners in a position where significant expenditure will be necessary to bring homes up to an acceptable level of energy efficiency.

As an encouragement to homeowners to assess energy efficiency of homes and undertake necessary remedial work, we recommend that a system of standard income tax rate tax credits be introduced. These tax credits should be made available to home owners who invest in order to make their homes more energy efficient. The tax credits should be conditional on certification that, after the remedial work, the residential unit meets a specified energy rating standard. The tax credits should be capped at what is considered a reasonable level of expenditure required to upgrade an average non-compliant property. Many of the properties concerned will be over twenty five years old and the expenditure cap set should reflect that fact.

In our view these tax credits will be self financing in that a significant amount of additional employment will be generated which will result in a flow of PAYE/PRSI and VAT into the tax collection system. A VAT invoice should be a requirement and an online VAT verification and tax credit claim system should be established to ensure the system operates efficiently at minimal additional administration cost to the Revenue Commissioners.

**Commercial and other property**

There are a large number of listed structures throughout the country which are in need of improvement. The cost of improving these structures is, in many cases, prohibitive. By way of example we refer to the stock of Georgian buildings in Dublin and similar buildings in other cities and larger provincial towns which are used as commercial office premises. These buildings, in the main, are expensive to run in terms of energy costs. The danger we see is that,

in time, many of these buildings will be allowed to decay for want of remedial expenditure to make them more attractive places to live and work. Such structures are an integral part of the urban environment and there is a need to encourage owners to undertake appropriate whole-scale renovation work to increase their energy efficiency in a meaningful way.

The current rules for allowing repair deductions in such circumstances are restrictive. Expenditure on improvement to the structure of such buildings is not allowed as an expense for tax purposes and capital allowances are not available either.

With the development of modern office buildings and business parks and the migration of businesses to these new developments will, in our view, remove much of the impetus that has, until recently, ensured that these structures were maintained properly with indirect benefit to the urban environment. We are concerned that, unless some measure of tax incentive is introduced, properties will continue to decay and move down market to the detriment of the urban environment and indirectly, the tourism industry. This will have serious negative impacts on the value of these properties and indirectly remove much of the potential exchequer gain when they are sold.

Large office buildings were constructed in our cities and towns over the last forty years. In most cases expenditure on the upgrading and retrofitting of these buildings is not allowed as a deduction for income tax or corporation tax purposes. These office buildings, much like the listed structures and other buildings referred to above, require a great deal of investment in order for them to meet today's energy efficiency standards and user requirements. As large structures in the urban setting, any dilapidations to these properties will have a disproportionate adverse impact on the general quality of the built environment.

The scheme of capital allowances for industrial buildings was established when Ireland was trying to make itself attractive for foreign inward investment in manufacturing industries. This is now a largely redundant incentive with government now focused on attracting internationally traded services, holding company operations, research and development facilities, etc. Given the changes in the Irish economy, these new industries generate ever larger tax revenues than traditional industries. There is no allowance for the investment made in these modern 'technology factories' to support the investment decisions being made by national and foreign businesses in the future of Ireland's economy. Other countries, such as Australia, grant capital

allowances on all expenditure on building generally. There is no appreciable overall tax cost of introducing such an incentive. The scheme of capital allowances is self regulating in that, on a sale of an asset which attracted capital allowances, there is a claw-back of allowances where the proceeds on sale exceed the tax written down value of the asset.

We recommend that the scheme of capital allowances for buildings be widened to encompass all buildings used commercially and that a special scheme of allowances be introduced to encourage commercial property owners to modernise their buildings and make them far more energy efficient. We are of the view that considerable benefit would accrue to the environment and the economy as a whole

### **Local Government**

Developers are required, as part of their planning permission procedures, to pay up front for the development of infrastructure and ancillary works before they can commence selling the residential units from which the profits should, in theory, flow to pay for these initial costs. The initial costs per unit can be as much as €50,000 per house and slightly lower for apartments.

Uncertainty in the housing market coupled with the current credit crisis means that banks are unwilling to support development expenditure necessary to create the initial impetus required for development projects. The result is a stagnant residential construction sector under pressure from lenders to improve liquidity.

Consideration should be given to a finding alternative solutions. One such alternative could be to reduce the developer charges and increase user charges. Another option to be considered is the granting, from central government, of soft loans to fund the infrastructure costs for the duration of a project. These loans could be repaid from the sale of units as they close.

## **Affordable Housing**

Currently there is a claw back in effect where a person who is in receipt of affordable housing, sells the property within the first 20 years of ownership. CIF proposes to extend that claw back indefinitely and in full. i.e. selling the house within 10 to 20 years will lead to a full clawback. This will create an ongoing fund for government to continue the affordable housing scheme. The clawback could be reduced where the house owner continues to meet the affordable housing criteria.

***Wider fiscal and business- related proposals*****PAYE Tax Credit**

Currently the PAYE tax credit is not available to proprietary directors or their spouses. This credit is currently set at €1,830 per annum per person. Proprietary directors are a key contributor to the wealth generating ability of the economy in the country. The exclusion of proprietary directors and their spouses is discriminatory and the restriction on its availability should be removed.

**PRSI Employers Ceiling**

The employers ceiling for PRSI should be reinstated. The removal of the ceiling was an extra burden placed on the employer during less challenging times. The removal of the ceiling had a disproportionate impact on the very industries and business that the government sought to attract to Ireland, e.g. high tech jobs, research and development posts, senior management, etc. A ceiling on the employer PRSI charge should be re-introduced to improve our international competitiveness and stimulate employment.

**PRSI Entitlements review**

The differences in entitlements available to Class S PRSI contributors as compared with Class A PRSI contributors should be reviewed. Particular attention is required to improve the position of proprietary directors and self employed persons who may require support on account of serious illness or injury. Class S PRSI is payable on all income with no upper limit whereas Class A PRSI is only payable up to a current cap of €50,700.

**PRSI Entitlements – Spousal anomaly**

Where a sole trader employs his or her spouse, that spouse is not entitled to benefit from Class A PRSI contributions. Many SMEs are run by husband/wife teams and their success is based on that dynamic approach. The application of this rule is discriminatory as it only applies to the employment of a spouse and not any other relative. In contrast, a partnership may employ the spouse of one of its partners, and he/she can benefit from Class A PRSI contributions.

**PAYE Minimum Entry Point**

Currently, where a person makes a payment to or on behalf of a person under a contract of service exceeding a rate equivalent to €8 per week, or, in the case of a person with another employment, €2 per week, the payer must register as an employer with the Revenue Commissioners. €8 is less than one hour's pay at the national minimum wage rate. These thresholds have not been reviewed for a long number of years and there is a case to be made that the thresholds should be revised significantly upwards.

The rules as they stand mean that any household in the country which employs a person on a casual basis to clean a house or mow a lawn should be registered as an employer or otherwise stand in breach of the law. This is a ridiculous situation which needs to be reviewed and improved.

**Educational Tax Credits**

Currently tax credits are only available on a restricted range of courses for an individual who opts to undertake further education. People should be actively encouraged to improve their educational standards throughout their lives. A tax credit should be available for certain educational course fees associated with personal or business improvement.

### **Preliminary Corporation Tax**

Preliminary Corporation Tax rules for small companies should be extended to all companies. Even allowing for the increase in the threshold from Finance Act 2007, it is still difficult to ascertain the amount of preliminary corporation tax due for a large company before a date that is six weeks before the end of its financial year.

### **Restrictions on tax allowable pension contributions**

Restrictions on investing in pension funds in terms of age and earnings should be reviewed to make the pension investment option more attractive.

Before a person starts a family, that person on average has more disposable income at that time in their life than they will have for most of the remainder of their working lives. That time, i.e. in their late 20's or early 30's, is considered to be the best time to start pension contributions. Pension contributions for persons younger than 30 years are restricted to 15% of net relevant earnings. This restriction is counter productive and should be scrapped.