

UNKNOWN ASPECTS OF THE 3% CONSTRUCTION TAX: By Jonathan Hore

Most of us may be aware that businesses paying for construction works must deduct 3% tax from the full contract price, as long as such contracts exceed P5 000 in value. Experience shows that most people know the fundamental aspects and not the intricacies of this tax. I want to analyse the hidden aspects of the 3% tax, which I hope will add value to you. In this article, words importing the masculine shall be deemed to include the feminine.

3% TAX IN BRIEF

The Income Tax Act requires that any payee of amounts charged in respect of 'construction operations' must deduct a 3% tax and remit the same to BURS. The term 'construction operations' is however not defined in the Act and it is therefore subject to varying views. BURS issued a guidance on the matter, which is not binding on both BURS and taxpayers. That guidance states that the tax is payable on, among others, the construction of buildings, roads and superstructures such as warehouses.

THE UNKNOWN ASPECTS

Experience shows that most people are not aware of the following matters:

- **Tax on mobilisation fees:** Most contractors request advance or down-payments before they start construction works, mainly to set up construction sites and purchase equipment or consumables needed to conduct the construction works. In practice, most businesses do not deduct the 3% tax from such payments on the premise that they are advance payments. The correct position is that the tax must be deducted on mobilization fees as withholding taxes are triggered by 'payment' regardless of whether or not the works would have indeed commenced.
- **No tax on repairs:** Repairs to a building which simply restore it to its former state are not construction works, hence the tax must not be deducted from such transactions. Common examples include re-painting and fixing worn-out roofs. However, any works which result in an increase in the value of the property such as renovations are most likely subject to the tax.
- **No tax on subcontractors:** A main contractor or any such person who engages a subcontractor may apply to BURS for waiver of tax on amounts due to the subcontractor. This is provided for in the Income Tax Act which prescribes for that concession on the basis that the subcontractor is paid from amounts subjected to the same tax when the first payment is made by the client/building owner to the main contractor. This provision is put in place to avoid double taxation, being the levying of the same tax more than once. The variation letter may be issued upon submission of an application by the contractor to BURS.
- **No tax on tax clearance certificate holders:** A holder of a valid tax clearance certificate must not suffer this tax as the Act provides that BURS may waive the tax, upon receipt of an application from the applicant.
- **No tax on fittings:** Some subcontractors are solely engaged by contractors to fit kitchens, aircons or fireworks and in practice, they suffer the 3% tax. Technically, this tax must be deducted on someone whose contract is to construct and fitting aircons and related works certainly are not construction works and must not be subjected to tax. However, if the fittings are part and parcel of the construction contract and are done by the same contractor, they may be subject to the tax.

- **Individuals don't deduct tax:** The 3% tax must not be deducted by individuals who are not in business as doing so puts state funds at the risk of being misused. Individuals who are in business as sole traders or partners etc can however deduct the tax. The reason for excluding individuals not in business is apparent; they can collect the tax and squander the funds and BURS may never know.
- **No tax on architects etc:** Persons solely engaged to offer architectural, engineering and related services do not offer construction services and should therefore not suffer the tax. However, tax would be deductible if the said services are an integral part of a construction operations contract done by the same contractor.
- **No tax on PPADB registrants:** The 3% tax must not be deducted from contractors categorized by PPADB under classes A, B and OC, if the contracts do not exceed P2m in value.

Conclusion

Withholding tax by nature usually causes divergence of views. Businesses are advised to seek professional tax advice where not certain on how to treat particular matters. Failure to deduct the tax makes the payer personally liable, hence this must be taken seriously.

Well folks, I hope that was insightful. As Yours Truly says goodbye, remember to pay to Caesar what belongs to him. If you want to join our Tax Whatsapp group, send me a text on the cell number below.