

JBCC ADVISORY NOTE: EDITION 6.2

DOCUMENT/S

Principal Building Agreement

Minor Works Agreement (Clause 18.0)

DISCLAIMER *The purpose of this publication is to give advice on the most effective use of the JBCC documents. Advice is given in good faith and JBCC disclaims all liability for any loss, damage or expense that may be incurred through acting on such advice*

24.0 PENALTY FOR LATE OR NON-COMPLETION - VAT

24.1 Where the **contractor** fails to bring the **works**, or a **section** thereof, to **practical completion** by the date for **practical completion** [CD], or the revised date for **practical completion**, the **contractor** shall be liable to the **employer** for the **penalty** [CD]

24.2 Where the **employer** elects to levy such **penalty** the **employer**, or the **principal agent** on instruction from the **employer**, shall give **notice** thereof to the **contractor**. The **principal agent** shall determine the **penalty** due from the later of the date for **practical completion** [CD], or the revised date for **practical completion**, up to and including the earlier of:

24.2.1 The actual or deemed date of **practical completion** of the **works**, or a **section** thereof [23.7.1]

24.2.2 The date of termination [29.8]

24.3 The **principal agent** shall include the **penalty** in regular **payment certificates** from the date on which the **employer's** entitlement to **penalties** commences

INTERPRETATION

When an **employer** elects to levy a **penalty** on the **contractor** for late completion or non-completion of the **works** as provided for in clause 24.0 the question arises whether it is required to charge VAT on the **penalty** or whether the penalty amount inserted in the **contract data** includes or excludes VAT

For a payment to attract VAT, it must comprise consideration for the supply of goods or services. For instance, if a local authority imposes a penalty for the excessive use of water (as happened in Cape Town recently) in the form of an additional charge for such usage, the penalty relates directly to the supply of the water, and as such attracts VAT. However, if the penalty is not paid in respect of goods or services, it does not attract VAT. For instance, a penalty levied in construction contracts

Penalties are pre-determined sums that become payable upon breach of contracts. In construction contracts penalties reduce the **contract value** the **employer** must pay the **contractor**, saving him the time and expense it would have to invest in a claim for general damages. Penalties in construction contracts are therefore by their very nature compensatory

The Guide for Fixed Property and Construction (VAT 409) as issued by SARS states the following on page 46 with regards to penalties: "*The effect hereof is the reduction of the contract sum agreed upon between the landowner and contractor, and consequently, a reduction of the value upon which VAT must be levied*". It further provides an example (No 39) on how to calculate VAT when penalties are levied, as follows (the previous 14% VAT percentage has been replaced with the current 15%):

. Contract sum inclusive of VAT R115 000
. Ddt: Penalties inclusive of VAT R 10 000
R105 000

VAT included: R 105 000 x 15/115 = R 13 695.65

In bills of quantities, payments and final accounts amounts are dealt with before VAT and VAT gets added at the end. Thus:

. Contract sum exclusive of VAT	R100 000.00
. Ddt: Penalties exclusive of VAT	<u>R 8 695.65</u>
	R 91 304.35
Add: VAT 15%	<u>R 13 695.65</u>
	R105 000.00

In both cases SARS will receive R13 695.65 VAT

SUGGESTED ACTION

The **principal agent** should, when inserting the **penalty** amount in the **contract data** at the start of the contract, state that the **penalty** amount excludes VAT to avoid any confusion whether the **penalty** amount is inclusive or exclusive of VAT