

Corporate pre year end tax planning – 31 December 2010

31 December is the year end for most companies. It is a worthwhile exercise to review the financial and tax situation of your company to identify tax saving opportunities that may require action before the year end.

We have set out below some of the main areas to be considered and actioned.

Utilisation of losses

Current year trading losses are firstly carried back to the prior period to be utilised against trading profits. Any excess losses can be set against other income and chargeable gains arising in the same period.

In light of the economic downturn, companies should review the carrying value of their trading stock e.g. land. Any write down should be tax deductible. This should reduce the corporation tax liability for the current year and, depending on the circumstances, may result in a tax refund for the previous year.

Maximising interest deductions

Ensure you are securing a tax deduction on all financing costs. Some interest costs may not be tax deductible. However, when structured correctly a tax deduction may be achieved.

Early filing

If you are due a refund of tax e.g. over-payment of preliminary tax, you should look to file a tax return as soon as possible in order to obtain the refund at the earliest possible opportunity. Effectively this is an interest free loan to Revenue. Revenue can in certain circumstances withhold repayment of tax refunds for up to three months without paying any interest.

Income recognition

It may be possible, depending on the accounting policy of the company, to defer income recognition until the following year end. Any associated tax payments on income deferred would be delayed by 12 months.

Stocking up/accelerating deductions

Purchase items your business will require in the immediate future to maximise deductions for this year. If there is a need for goods and services in the first quarter of the new year, buy them now, if cash flow permits. Depending on method of accounting consider stocking up on office supplies e.g. fax paper, printer cartridges, stationery and other office items.

There is no advantage in purchasing goods that are held as trading stock, the cost of these goods would be included in closing stock at the year end thereby having no effect on your taxable profit.

Bad debt provisions

Relief for bad debts is given for tax purposes where it is shown to the satisfaction of the Inspector of Taxes that the debt is bad. A deduction is also available for doubtful debts to the extent that they are estimated to be bad i.e. a specific bad debt provision. Claims in respect of bad debts are made when filing the relevant corporation tax return.

A VAT refund in respect of a bad debt can be claimed where it can be demonstrated that the debt is not recoverable.

Capital allowances

Capital allowances are available on plant and machinery and some buildings. You can deduct a proportion of these costs from your taxable profits and reduce your tax bill. To qualify for capital allowances, the plant and machinery must be in use for the purposes of the trade at the year end. If you intend to buy new plant and machinery early in the following period you might consider purchasing it before the year end to get an immediate allowance in the current year. It should be noted that if additions are made in December and the year end is 31 December, you should be entitled to capital allowances for an entire year notwithstanding the fact that the assets were only being used for one month of the accounting period.

Where fixed assets additions qualify as eligible energy efficient capital equipment, the company can deduct the full cost of this equipment from their profits in the year of purchase. The equipment eligible for such allowances can be found on the specified products list issued by Sustainable Energy Ireland.

Start-up exemption

New companies that have commenced trading in 2009 or 2010 are exempt from corporation tax and capital gains tax until 2011 or 2012 (for three years) respectively provided that their tax liability in the year does not exceed €40,000. This represents the potential to shelter taxable profits of €320,000 per year or €960,000 over the three year period.

The relief applies to tax arising on trading profits, including capital gains tax arising on the disposal of assets used in the trade. The relief applies for three years from the date that the company commences to trade. There are certain anti-avoidance provisions and the entitlement to such an exemption should be reviewed in detail prior to any claim being made.

Pension contributions

While a cap has been introduced, on the value of a pension fund that is tax effective, this is one of the most tax efficient ways of extracting wealth from a business. A company is entitled to a tax deduction for contributions paid to an approved pension fund for employees and directors. On reaching retirement age, an individual can extract 25% of the fund value (subject to certain limits) tax-free and use the balance to purchase an annuity or, more likely, invest in an Approved Retirement Fund (ARF).

To ensure the pension contribution is available for corporation tax purposes, the contribution must be paid and not accrued at the year end.

It is important to be aware that the maximum allowable value of a pension fund is €5,418,085. Further caps may be introduced. In particular any provisions introduced in the 2011 Budget should be considered.

The recent Four Year Plan has heralded the introduction of widespread changes to the existing pension relief for individuals. Going forward, planning around corporate contributions may become more attractive.

Crystallise losses on capital assets

If you are holding assets e.g. share investments, that if sold would create a loss, you might consider crystallising these losses to be offset against capital gains. This effectively locks in the loss and acts as a gross roll up vehicle for future gains; excess losses can be carried forward to future periods. Current year losses may also reduce gains made earlier in the period.

A review of a company's investment portfolio should be carried out before the year end to identify opportunities to crystallise losses and any negligible value claims. Care should be taken not to fall foul of the "bed and breakfast" rule i.e. if the shares are reacquired within four weeks, the loss is ring fenced and that the loss/gain is in the same company. However, there are methods to overcome this restriction.

Close company surcharge planning

Companies which are under the control of five or fewer participators and are in receipt of passive income e.g. rents, investment income, or professional services are obliged to distribute their income by way of dividend or incur a surcharge of 20% on that income. It may be possible to put in place certain structures which could avoid the requirement to make a dividend and the surcharge liability.

Patent schemes

Unfortunately, it would appear that the tax exemptions for patent royalties and dividends have been abolished with effect from 24 November 2010.

Research and Development (R&D) tax credit

The R&D credit is currently calculated at 25% of the excess of R&D spend in the year of assessment over the R&D spend in a set base year. This includes expenditure on revenue items, royalties and plant and machinery related to R&D. The credit can be offset against the company's corporation tax liability in the year in which the expenditure is incurred. Combined with a likely 12.5% standard trading deduction for R&D expenditure, this means that there is a potential **37.5% cash tax rebate** for qualifying R&D expenditure.

With effect from 1 January 2009, all claims must be made within 12 months of the end of the period in which the relevant expenditure was incurred. It is thus imperative if you have unclaimed R&D tax credits for the year ended 31 December 2009, that claims for such credits are submitted prior to 31 December 2010, otherwise the benefit of the credit for that year is permanently lost.

Intellectual property

A new scheme has been introduced, with effect from 7 May 2009, to provide relief for expenditure by companies on "specified intangible assets".

To claim the tax relief, it is noteworthy that companies must actively "trade" with their newly acquired intangible assets, thereby ensuring that there is an active involvement with the assets and, presumably, a resultant increase in learning/knowledge.

The definition of specified intangible assets is quite broad, and includes patents, patent rights, design rights, trademarks, computer software, brand names, licences, copyright, know-how and goodwill associated with the foregoing.

The allowances available for tax purposes will generally follow the standard accounting treatment applicable to the acquisition of intangible assets; however an election can be made to instead spread the expenditure over a 15 year period (7% in years 1 to 14 and 2% in year 15).

There is a restriction on the amount of allowances available, together with a new restriction on interest incurred to acquire the intangibles used in the trade. The aggregate of the allowances and any related interest incurred on acquisition of the intangibles cannot exceed 80% of the trading income from the “intangibles” trade (which is treated as a separate trade). The objective here is to ensure that the acquisition of the intangibles results in a net increase in the taxable income of the company, as opposed to merely reducing taxable profits.

Change of year end

A change of year end can be useful in group situations. Companies can shorten or lengthen their accounting period (subject to company law) to maximise the amount of losses being transferred from one company to another. Only contemporaneous losses can be surrendered and claims are limited to profits of a corresponding period. Where accounting periods are shortened, payment of tax liabilities may be accelerated. For seasonal businesses, it can be beneficial to choose a year-end date just before a seasonal surge in income and profitability. This gives the maximum delay between earning the profits and paying the tax.

Cash flow saving – review basis of VAT payments

Under the invoice basis of accounting for VAT one must pay over VAT for the VAT period in which the invoice is raised. Under cash receipts basis, one does not account for VAT until they have actually received payment for the goods and services supplied. In a time where there is a longer delay in invoices being paid companies may consider changing to a cash receipts basis (subject to application to Revenue).

The cash receipts basis applies where:

- annual turnover does not exceed or is not likely to exceed €1,000,000; and
- supplies of goods or services are at least 90% made to unregistered persons or to persons who are not entitled to claim a full deduction of the tax chargeable on the supply to them.

Relief for investment in renewable energy generation

This relief is available for corporate investment in renewable energy generation (including wind farms, bio mass, hydro power and solar power). A company can get a tax deduction of the amount of a relevant investment made by it in a qualifying company i.e. a company carrying out a renewable energy project.

The amount that can be invested in any one project cannot exceed 50 % of the relevant cost of the project or €9.525m, whichever is the lesser. A company can, however, invest up to €12.7m in various projects in a 12 month period.

Employment of family members/spouses

Most Irish businesses are, to some extent, family businesses with family members often working on an informal basis at weekends or evenings. We would recommend that such employees be paid and that they be dealt with as other employees through the PAYE system. The tax advantages include:

- additional personal tax credits;
- utilisation of low rate tax bands – Most people are by now aware of the advantage of employing a spouse to avoid the individualisation rules. The same benefits apply equally to children of all ages who work in the business;
- termination payments – relatives and children qualify in the same way as other employees for tax exemption on ex-gratia termination payments when they cease employment;
- scope for use of pension schemes to effectively and tax-efficiently pass wealth to the next generation; and
- capital gains tax relief is available on a sale or liquidation of a business where the shareholder has reached 55 years and satisfies other conditions. For example they have worked full time in the business for five out of the last ten years. Where the sale proceeds in respect of the shares is €750,000 or less then the gain is fully exempt. An individual can double that threshold simply by ensure that their spouse also satisfies the various conditions – working requirement, period of ownership, age. If a shareholder is approaching 55 they should take advice as to the actions that may need to be implemented before (and after) they reach 55. If you sell your business to your children, subject to certain conditions, no capital gains tax arises regardless of the value sold. It is important to be aware that it has been recommended by the Commission on Taxation that a cap be put on such transfers.

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Structuring for the upturn

“Share freezes”

With share values in companies at their lowest level for some time, now is the time to consider passing on the future uplift in values to the next generation with no tax cost. If control of the company is an issue then this can remain with the existing shareholders. One method of achieving the above is a “share freeze” and the issue of a new class of shares. Care needs to be taken in any drafting to ensure the objective is achieved.

Transfer assets into Ireland

On a global scale, asset values have decreased in value. Now may be the time to identify those assets where values have dropped e.g. intellectual property, financial assets, which are held in foreign subsidiaries where the tax rate is higher. There may be merit in transferring those assets into Ireland where any future uplift may be taxable at a lower rate 12.5%/25%.

Contact us

The foregoing pre year end opportunities are only intended to outline some of the possibilities available to reduce your tax exposure. Naturally it does not only apply to year ends ending on 31 December and can apply in respect of all companies.

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