PUTTING TAX IN THE PICTURE

Peter Vale, tax partner with Grant Thornton, provides some expertise on the liabilities and exemptions every budding technology entrepreneur should be familiar with

Numerous success stories have come from within the technology industry, both here and in the United States, in the last number of years. A significant number of start-ups were founded out of necessity by people who lost their jobs during the recession.

Although this has been the case across a broad range of sectors, many tech companies in particular have soared to fantastic heights. Technology start-ups have also attracted vast amounts of investment during this time and according to Peter Vale, tax partner with Grant Thornton, that looks set to continue.

With this in mind, it's worth examining what it takes to start a tech company in terms of tax liabilities and exemptions or credits available to those who might be filled with entrepreneurial spirit. It's also important to consider the expansion and growth phase of a tech business and how best to manage profits and wealth.

To begin with, Vale says the Government has tried to make it attractive for tech start-ups to set up in Ireland by giving them tax breaks for the first few years of their activity.

That means a tranche of the profits can be earned tax free and it gives companies more working capital to reinvest in the business.

"They can earn up to about €400,000 of profit in the company for the first three years without paying any tax and that's linked to their employment. So to get the best out of that tax break they need to have a certain amount of employees and eight is the magic number. It's an incentive linked to employment, so to get the most out of that corporate tax break you're encouraged to employ more people," he says.

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The "magic number" of employees that maximises a start-up's tax break thus acting as an incentive for companies to hire

Another incentive lies on the investment side of things. The erstwhile Business Expansion Scheme (BES) is now the Employment and Investment Incentive (EIIS) scheme and this is an incentive for investors to put money into a tech company.

"Say you're an investor and you put €50,000 into a tech start-up, you can get a tax break for that €50,000. The benefit would account to about €20,000 as it is a 40 per cent tax break on €50,000 – very attractive for an investor." he says.

Another enticing tax break is in the area of research and development.

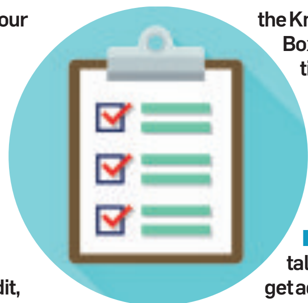
"Many tech companies will be doing R&D, maybe a small amount might even hire people to do development work for them and there is another break there – the Research and Development Tax credit, which is very attractive. If they spend €100,000 on developers in a year they get €25,000 back from the exchequer as a rebate. That's de-risking their spend; they're getting that back as a refund irrespective of how well that company does. If you're a small company this can be a very important part of your plan for the first three years as you know you're getting this back. You can afford to hire the guy because you're getting a rebate from the exchequer," says Vale.

Deduction

The Knowledge Development Box came onstream on January 1st, 2016, and a company which qualifies for this will be entitled to a deduction equal to 50 per cent of its qualifying profits in computing the profits of its specified trade. In effect, the profits arising from patents, copyrighted software or intellectual property equivalent to a patentable invention are taxed at 6.25 per cent.

Need to know basics Advice for starting out

- **Don't overcomplicate your structure – keep it simple because if you do want to sell at some point you don't want a buyer looking in, wondering what is going on within the business.**
- **Avail of all tax relief facilities available to you including the R&D tax credit, the Knowledge Development Box and the start-up exemption.**
- **Be aware of incentives that are available to investors in your company.**
- **If expanding overseas talk to Enterprise Ireland and get advice early.**



Vale says, "The Knowledge Development Box can enable a company to effectively half its corporate tax rate, to 6.25 per cent. To get the maximum benefit, a company should be doing all of its R&D in Ireland, or alternatively subcontracting it to third parties.

"Broadly, to the extent that the company's income is related to the fruits of that R&D, the tax rate is reduced, to a potential 6.25 per cent. Interestingly, this is likely to prove most attractive to Irish tax start-ups that are doing all of their R&D in Ireland.

"The R&D tax credit, which is a rebate on your costs, is good and for the profit bit the Knowledge Development Box is a very nice added incentive. The two can work together and you can reduce your costs. It's effectively increasing the amount of cashflow available to tech companies to reinvest in the company."

Tax partner with Grant Thornton, Peter Vale: The Knowledge Development Box can enable a company to effectively half its corporate tax rate, to 6.25 per cent

Payroll

Inevitably though, there are taxes that every start-up must pay from the beginning.

"You've got the usual payroll taxes and that's still an issue for tech companies, you're left with very high marginal tax rates so those reliefs go some way to mitigating some of the pain we're still stuck with."

"There is another thing they can do to mitigate some of that personal tax: if you are claiming the R&D tax credit it specifically is an incentive for the company but the company can say, 'well look I have this tax break but I will give it to my employee', so the company can surrender that tax break to its R&D employee. That's a relatively new initiative. Effectively it's like a tax-free bonus. There are limits and restrictions on it but you can give a chunk of money tax free to employees that are carrying out R&D."

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Many investors voice the concern of, if they want to exit the business, are they going to be crippled with Capital Gains Tax?

"There is an entrepreneurial relief. The normal capitals gain rate is 33 per cent and that's a relatively high rate. There is a reduced rate of 10 per cent for entrepreneurs which is available for the first €1m of proceeds on certain disposals," he says.

The other route to reducing your Capital Gains Tax is to set up a personal holding company but that only works if the person exiting the business is going to reinvest the proceeds of the sale into a new business, creating more employment as they do so.

Cash flow

With start-ups, cash flow is often an issue but one way of remunerating employees is through share options. "It would be a pretty common way of remunerating people but it has been fairly penal in Ireland so if you give someone shares they're going to be taxed at the marginal tax rate – 52 per cent tax on the value of the share, so it's not a great option.

"The Department of Finance is looking at ways to make it more attractive to encourage more share ownership. If you look at Ireland compared to the US, share ownership is negligible," he says.

In terms of putting their equity at risk, Vale says there are incentives for owners to pump their own money back into the business and these tax breaks are based on employment: if a company increases employment after three years, effectively its tax breaks go up as it's of no cost to the exchequer.