



The Irish Accounting & Tax Summit 2020

Session 2

Entrepreneur Relief – Tips and Traps and Anti-Avoidance



Presenter:

Amanda Janye Comyn – Doyle Keaney Tax Advisors

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OmniPro Education & Training
Main Street, Ferns, Enniscorthy, Co. Wexford
053 9100000
www.omnipro.ie info@omnipro.ie

Doyle Keaney Tax Advisors

Entrepreneur Relief – Tips and Traps and Anti-Avoidance

Presented by Amanda-Jayne Comyn

Topics to be covered

1. Overview of Relevant Tax Reliefs

- Review of relevant reliefs on an exit from a business
- Review of relevant conditions for relief

2. Case Studies

- Six case studies looking at various issues arising on meeting Entrepreneur Relief conditions
- Tax trips and tips to qualify for Entrepreneur Relief

3. Anti-avoidance on funding an exit

- Overview of Section 135 TCA
- Review of main practical issues relating to amendments
- Examples of transactions when Section 135(3A) may have application

Exiting a Company as a Shareholder

Exiting Mechanisms:

- The market for shares in a private company is limited usually to the following:
 - Existing shareholders
 - Company itself
 - Third party
 - MBO team

Tax Treatment of Share Redemption/Buyback

Main Tax issues:

- a) Capital Gains Tax v income distribution in the hands of the recipient shareholder
- b) DWT if income distribution
- c) Stamp Duty for company

Tax Treatment of Share Redemption/Buyback

Capital Gains Tax

- a) Section 130 TCA 1997 - an anti-avoidance provision countering arrangements whereby shareholders might extract profits from a company without attracting tax liability under Schedule F
- b) Chapter 9 Part 6 TCA 1997 – permits CGT treatment provided the conditions set out in Section 176 TCA 1997 are met.

Tax Treatment of Share Redemption/Buyback

Conditions which must be satisfied under Section 176 TCA 1997:

1. Must be an unquoted trading company
2. Must have owned the shares for a period of at least five years ending on date of disposal
3. Shareholder must be both resident and ordinarily resident in the State
4. Wholly or mainly for the benefit of the company's trade
5. Remaining shareholding must not exceed 75% of what it was pre buyback
6. Must no longer be connected with the company

Tax Treatment of Share Redemption/Buyback

Wholly or Mainly for the Benefit of the Company's Trade

Revenue Guidance states where:

1. Disagreement between the shareholders over the management of the company
2. Purpose to ensure that an unwilling shareholder who wishes to end his/her association with the company

Tax Treatment of Share Redemption/Buyback

Stamp Duty

- No specific exemption
- Usual that the share purchase agreement is relied on to prove the transfer with no stock transfer form executed and therefore no document which to levy stamp duty
- Recognised by the Revenue Commissioners:

“The shares can be bought back on foot of a contract or share purchase agreement. If the shareholder and the company enter into an agreement and the shareholder simply hands over the share certificates to the company there is no need for a stock transfer form and no duty can be charged. The share purchase agreement is not chargeable to duty as it falls outside the scope of s31, Stamp Duties Consolidation Act 1999 (stamp duty on contracts)”

Reliefs on Exit from a Company

Exiting a company involves the disposal of shares from a company. As the disposal of shares constitutes the disposal of a capital assets, relief from capital gains tax may be available.

1. Retirement Relief

- Relief on disposal of chargeable business assets - TESTS
- Lifetime threshold between €500k and €750k – exempt with balance at 33%

2. Entrepreneur's Relief

- Relief on disposal of chargeable business assets - TESTS
- Lifetime threshold €1,000,000 @ 10%

3. Participation Exemption

- Holding period
- Complete exemption
- Shares meeting certain criteria

Entrepreneurs Relief – S.597AA TA 1997

What is the relief?

- Reduced capital gains tax rate – 10%
- Lifetime limit of €1,000,000

When does it apply?

- Disposal by a relevant individual
- Of chargeable business assets
- On or after 1 January 2016

Entrepreneurs Relief – S.597AA TA 1997

Who is a relevant individual?

- Individual
- *Beneficial owner* of the chargeable business assets
- For a *continuous period* of at least 3 years during previous 5 years
 - Cannot aggregate periods of ownership
- Additional criteria for shares
- Interaction with section 586 & 587 – period of ownership of "old shares" taken into account
- Transfers between spouses - can period of ownership of spouse be included?

Entrepreneurs Relief – S.597AA TA 1997

What are chargeable business assets?

- Defined in section 597AA(2)
 - ✓ Assets used for the purposes of a **business** other than the:
 - holding of securities or other assets as investments
 - holding of development land
 - development or letting land
 - ✓ Goodwill
 - ✗ Shares*, securities or other assets held as investment assets
 - ✗ Development land
 - ✗ Assets on the disposal of which no chargeable gain would arise
 - ✗ Assets used for "bad" trading activities listed above

Entrepreneurs Relief – S.597AA TA 1997

Shares as qualifying assets

What type of company qualifies for relief?

- Company whose business consists wholly or mainly of carrying on a *qualifying business*
or
- *Holding company* of a *qualifying group*

Definitions

- Qualifying business - any business other than the holding of securities or other assets as investments, holding of development land, developing or letting land
- Holding company – company whose business consists wholly or mainly of holding of shares in companies which are its 51% subsidiaries
- Qualifying group – group where business of each 51% subsidiary (other than holding companies) is a qualifying business

NB: Test applied on a company by company basis – not "wholly or mainly trading group"

Retirement Relief – S.598/599 TA 1997

- provides relief from CGT disposals where:
 - individual making disposal **55 years** or over and **used assets for the purpose of the business for at least 10 years**;
 - where assets being disposed of comprise shares in a family company (**25% of voting rights are held by the individual** or not less than **75% of the voting rights are held by the individual's family** and the individual holds at least 10%), the shares must have been held for a period of **10 years**, ending on the date of disposal and must have been a director for the 10 years of which 5 is a full time working director
- a limit of **€3m** will apply to disposals on or after 1 January 2014 made by an individual aged 66 or over;

Investment Assets and Dilution of Reliefs

- a qualifying business must be a business operated for profit and not carrying on a business consisting wholly or mainly of dealing in land, shares, securities or currencies or of making or holding investments.
- if the shares derive part of their value from investment assets (i.e. non trading assets) the relief available will be restricted accordingly
- **if more than 50% of the value of the company is derived from investment activities then there is no relief available.**

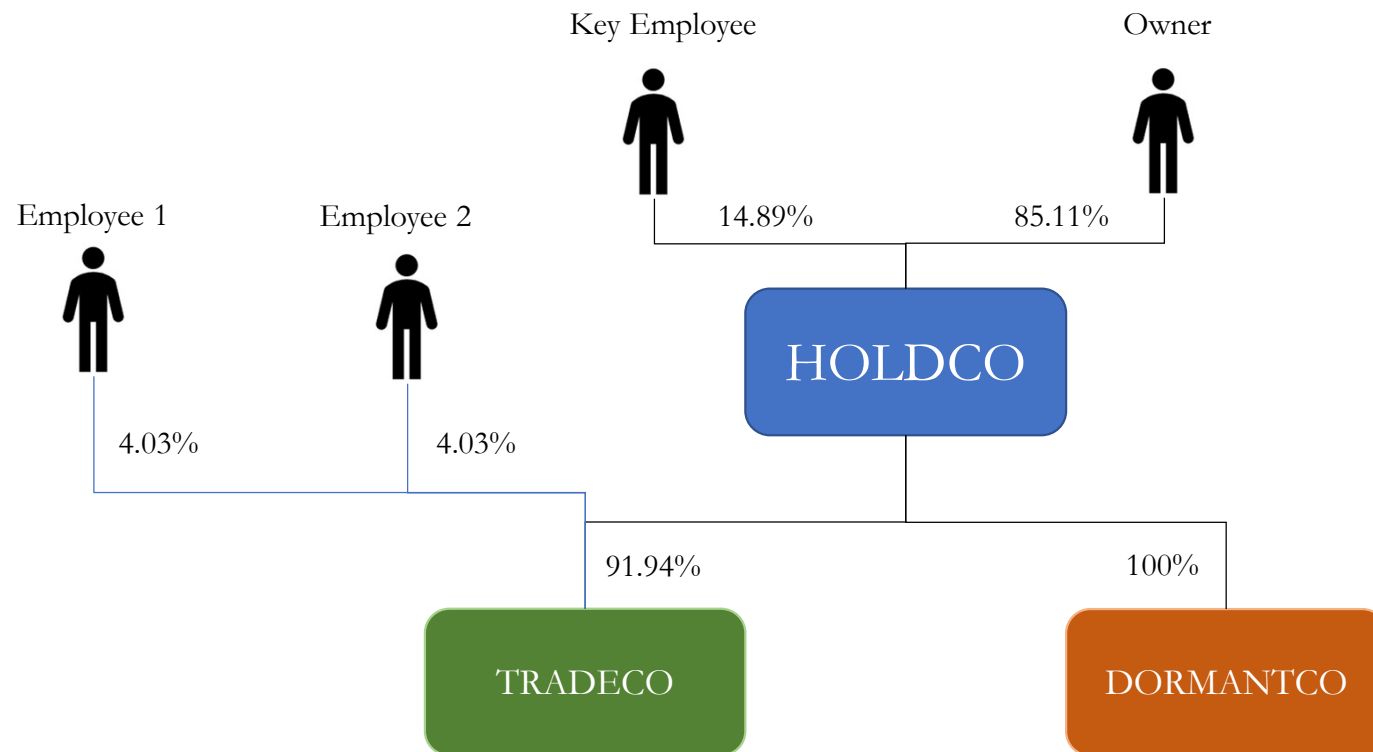


Participation Exemption – S.626B TCA 1997

- in certain circumstances, full relief from CGT available to Irish holding companies in respect of gains arising on disposal of shares in certain subsidiaries, provided:
 - the holding company must hold at least 5% of the ordinary shares in the subsidiary for 12 months at any time within the 2 years prior to disposal;
 - the holding company must also be beneficially entitled to 5% of the profits of the subsidiary and 5% of the assets on a winding up of the subsidiary;
 - the subsidiary company must be tax resident in the EU or in a country with which Ireland has a double tax treaty; and
 - the subsidiary must be an active trading company or part of a trading group
 - the shares in the subsidiary must not derive **their value or the greater part** of their value directly or indirectly from Irish land.

Case Study 1

Company Group Structure

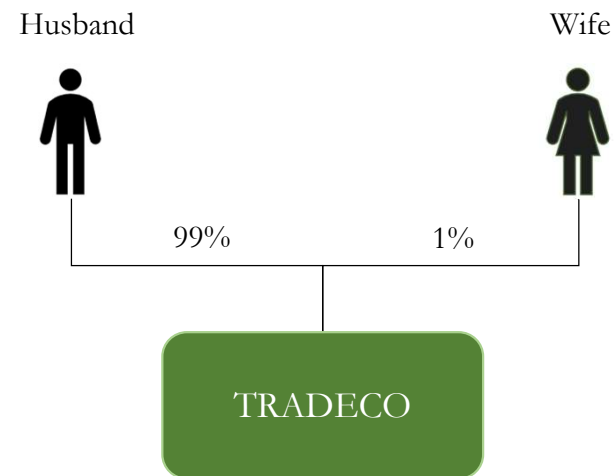


Shareholders of Trade Co

TRADECO									
Name of Shareholder	Ordinary Shares	% of Ordinary Shares Held	Preference Shares	% of Preference Shares Held	A Ordinary shares	% of A Ordinary Shares Held	% of Entire Issued Share Capital Held	Nominal Share Capital	% of Entire Nominal Share Capital
Holdco	1,111,111	100%	296,617	100%	-	0%	91.94%	11,114.076	98.9014%
Employee 1	-	0%	-	0%	61,728	50%	4.03%	61.728	0.5493%
Employee 2	-	0%	-	0%	61,728	50%	4.03%	61.728	0.5493%
Total								11,237.53	
Combined Total of Ordinary Shares, Preference Shares and A Ordinary Shares	1,531,184								

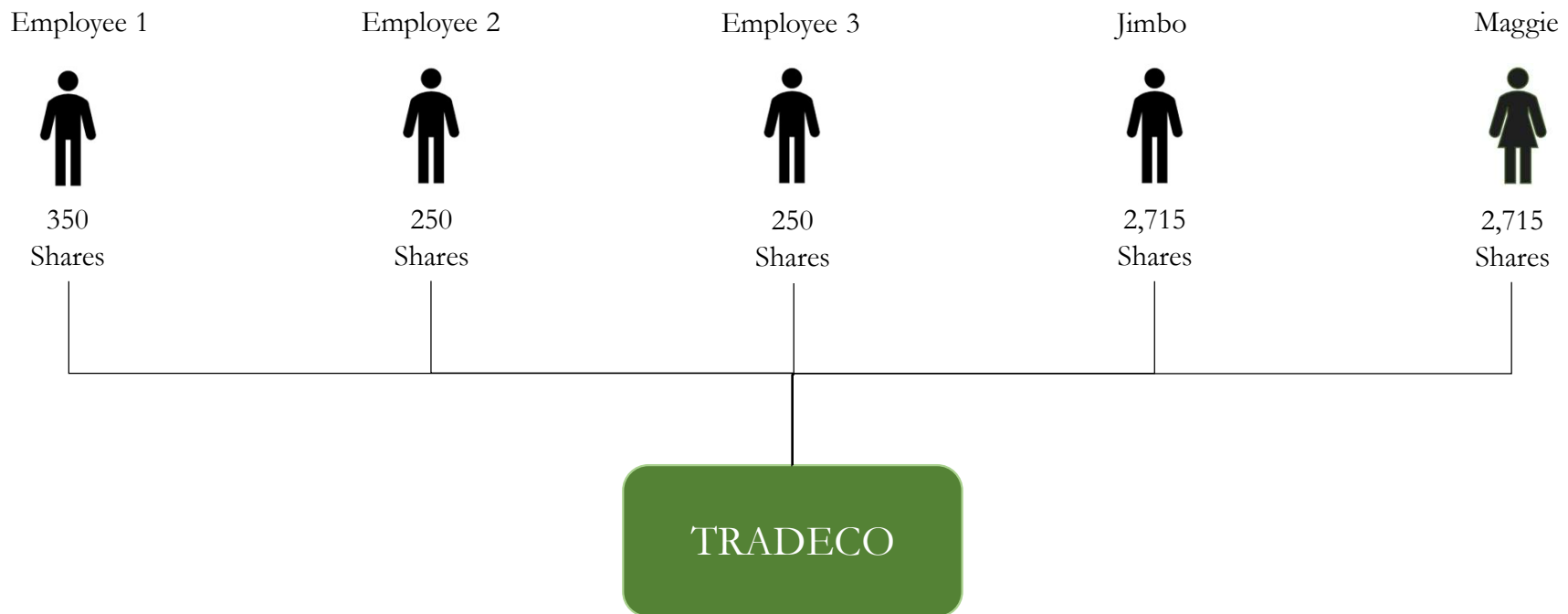
Case Study 2

“Beneficial Owner”



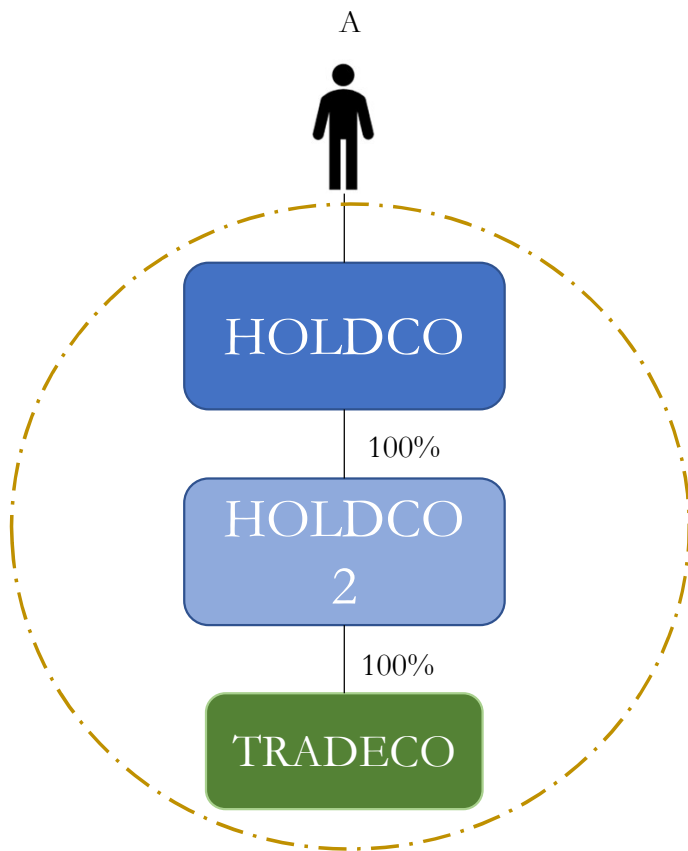
Case Study 3

Current Structure



Case Study 4

Shares as qualifying assets - Liquidation



Disposal of shares by A

- Group comprises HoldCo, HoldCo2 and TradeCo
- Group is a qualifying group
- ER may be available
- 2 Options:
 1. Sell trade and receive proceeds into Tradeco and dividend up and liquidate
 2. Sell shares in tradeco and receive proceeds into Holdco2 and dividend up and liquidate
- **No relief in either scenario above**

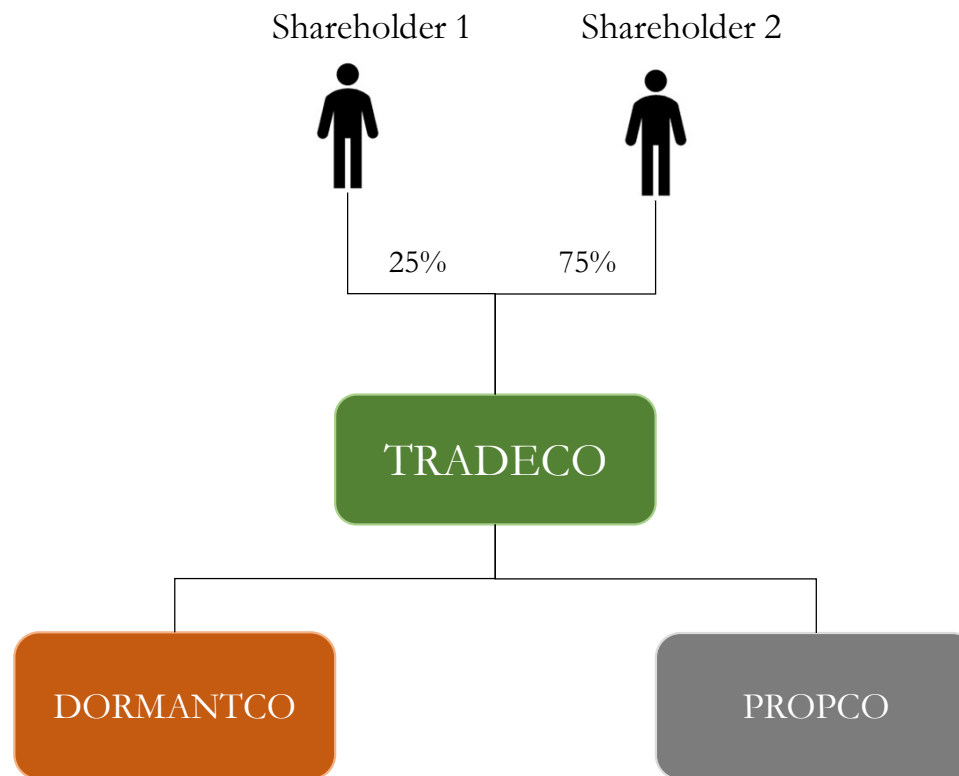
ER Guidelines – Questions for Relief

Entrepreneur relief conditions

1. Does one own 5% or more of Ordinary shares personally
2. Has one owned them for 3 years or more
3. Has one worked more than 50% of ones time in the business in 3 years prior to sale

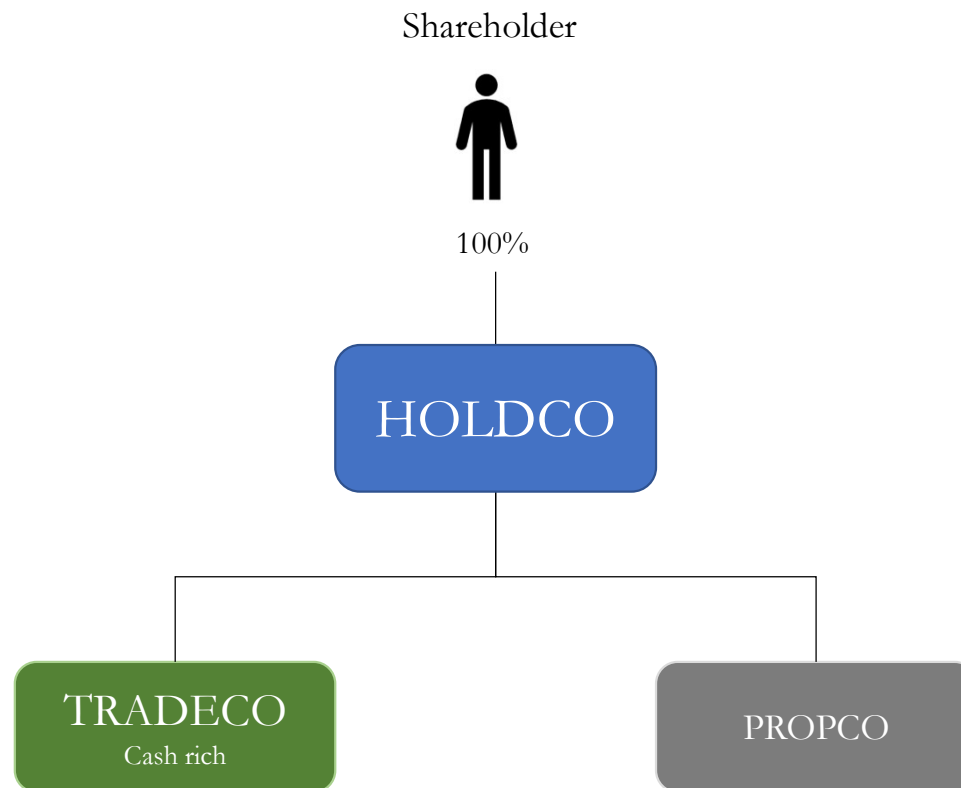
If YES to all 3, then 10% CGT rate on first €1m of gains per person

Case Study 5



Case Study 6

Future Planning



S.135(3A) TCA 1997

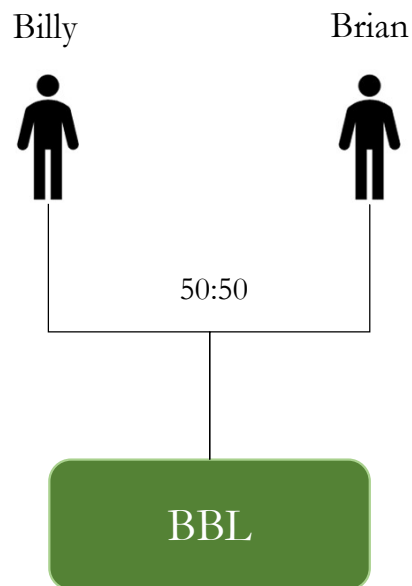
- Section 135 TCA 1997 deals with distributions for income tax
- Section 23 Finance Act 2017 introduced anti-avoidance measures to target certain “mischiefs”
- Section 135(2A) TCA 1997 disallows the capitalisation of share premium on a share for share transaction allowing an uplifted base cost for the shares that are held as part of the reorganisation
- Section 135(3A) TCA 1997 seeks to charge to income tax certain payments in relation to the disposal of shares in a close company where the shares are acquired by another close company and the funds for the acquisition are essentially provided by the target company

S.135(3A) TCA 1997

- Issues
 - Broadly drafted
 - Captures transactions that are bona fides commercial transactions that were not apparently targeted
 - No bona fides test
 - Revenue Guidance
 - Number of transactions that appear to be caught in the legislation:
 - Management Buyouts, EIIIS Exits, Share Scheme Exits, Deferred Consideration, Bona Fides Exits of Retiring Shareholders

EXAMPLE 1

Billy wants to retire (but Brian can't afford to buy him out)



Facts

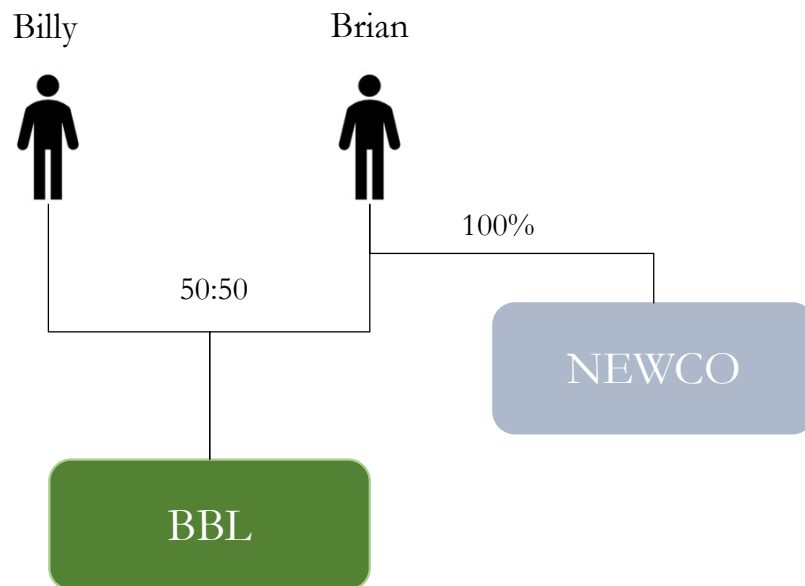
- Billy and Brian run a garage and own BBL equally
- Cash reserves built up of €1.4m
- Billy wishes to exit
- Buyback would result in an income distribution (no trade benefit test)
- Brian can't afford to fund the acquisition himself

Question

- Does 135(3A) TCA 1997 to this transaction?

EXAMPLE 1 – Step 1

Brian forms a new company

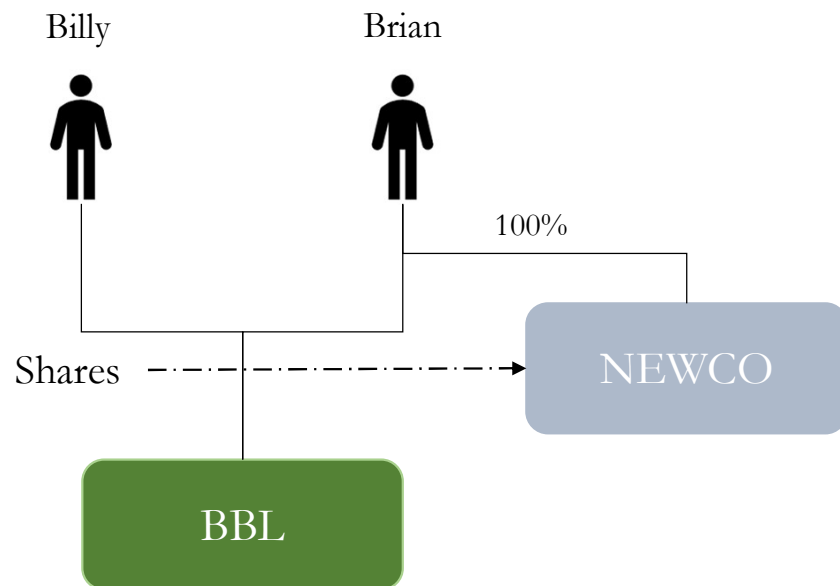


Facts

- Brian sets up a new company (Newco)
- Newco is to purchase Billy's shares

EXAMPLE 1 – Step 2

Billy sells his shares to NEWCO (Payment deferred)

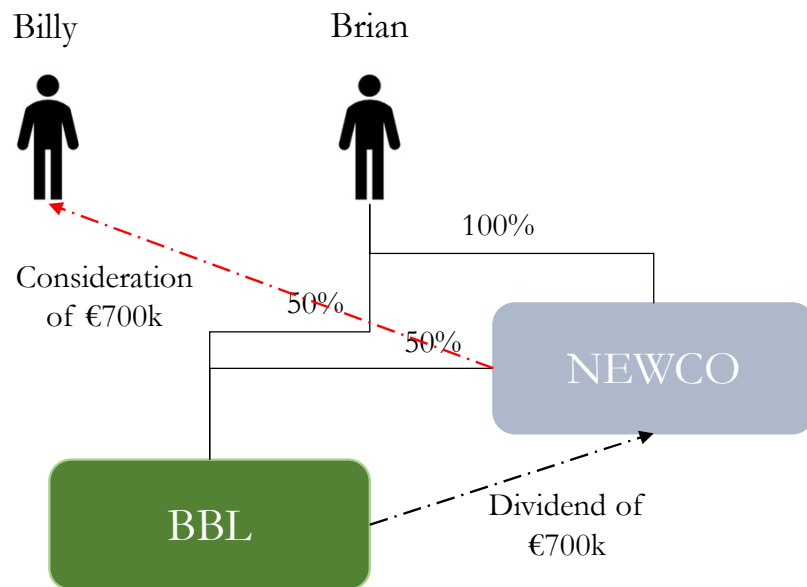


Facts

- NEWCO purchases shares for €700k with consideration left outstanding

EXAMPLE 1 – Step 3

Dividend to NEWCO and Payment to Billy



Facts

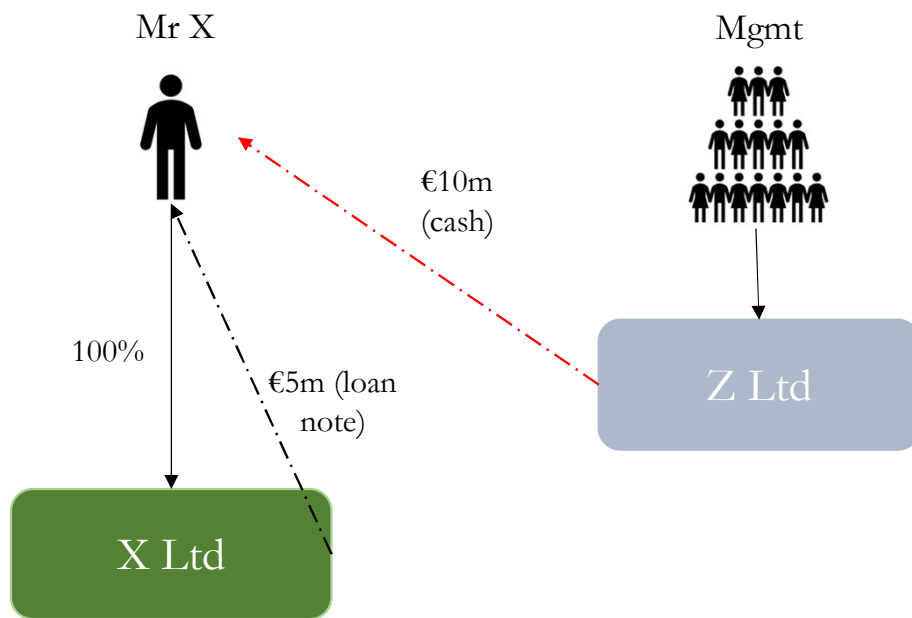
- BBL subsequently pays a dividend of €700k to Newco
- Newco discharges the consideration for the shares

Consequences

Section 135(3A) applies so that the €700k is taxed as an income distribution in the hands of Billy as the consideration was part of an arrangement by Brian to secure consideration to be paid to Billy and the assets of BBL have been depleted

EXAMPLE 2

Mr X wants to sell his business to the Management Team



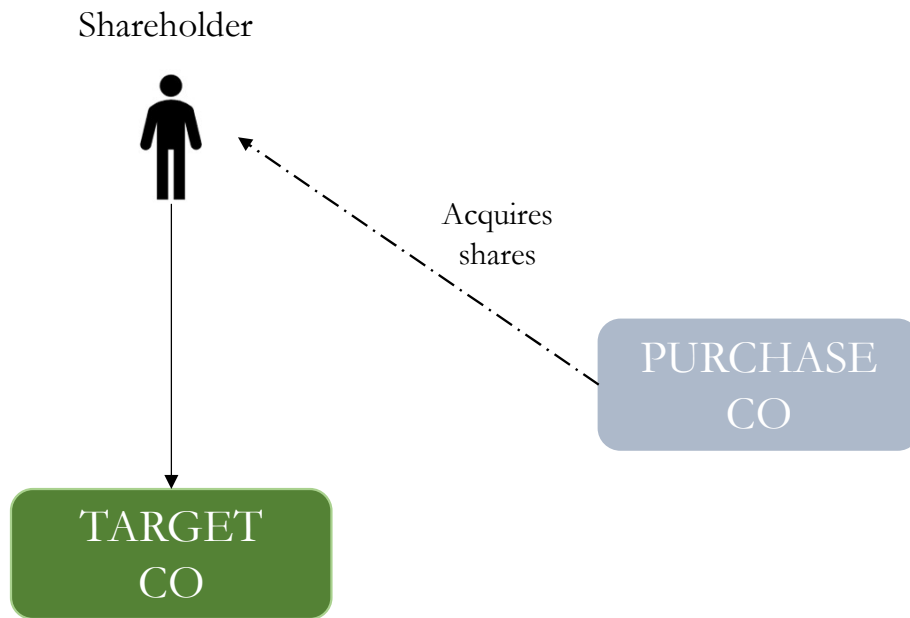
Facts

- X Ltd (TradeCo) is owned by Mr. X
- Management wish to buy out Mr. X and establish Z Ltd
- Consideration for acquisition = €10 million plus €5 million in loan notes (issued by X Ltd)
- 3 years later X Ltd redeems loan notes

Consequences

- Once consideration has been paid, there should be no look-forward approach as 135(3A) is applied on the point of payment of the consideration
- Accordingly, subsection (3A) should not apply

EXAMPLE 3



Facts

- Both close companies
- Deferred consideration for acquisition of shares of exiting shareholder to be paid in three tranches:
 - X on completion
 - Y after 12 month
 - Z after 24 months
- Cash reserves of Target company may be needed to fund elements Y and Z of the deferred consideration

Question

Does Section 135(3A) catch this transaction?

KEY POINTS

Section 135 TCA

- Must be considered for every transaction that involves a close company and the exit of a shareholder
- Bank funding should be considered in all circumstances where there is a doubt as to the application of the section
- Building cash reserves on a balance sheet should be reviewed

Key Opportunities & Pitfalls

- Exit strategy key to any planning
- Watch 5% and >50% ordinary share capital conditions
- Check historic disposals of chargeable business assets
- Section 135 must now always be considered where shares being sold
- Timing is crucial where a number of disposals and managing tax relief
- Commercial rationale should be discussed and documented
- Group structure and shareholders must be carefully examined
- Spouses and opportunities examined early in exit planning

Doyle Keaney Tax Advisors

TAX ISSUES ON EXITING A BUSINESS

For further details contact:

Amanda-Jayne Comyn

E: amanda@doylekeaney.ie

T: 087 975 9349