KIERAN RYAN & CO.

CHARTERED ACCOUNTANTS

Presentation to the Institute of Geologists of Ireland

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Profile of Kieran Ryan & Co

- Established late 1980s
- 5 partners; 30 staff overall
- Tax, audit and corporate services, including corporate recovery
- Based in Dublin 2
- Wide client base, mainly domestic market
- Reputation as problem solvers

The Current Business Environment

Context for presentation

- Very difficult trading environment
- Cashflow is generally very tight
- Legitimate sources of cashflow welcome
- State supports for small businesses
- Clever use of tax system = cashflow support

Areas to be covered

- Business Set Up-Optimal Structure
- Employee Remuneration
- Tax and Cashflow Issues
- Tax Reliefs
- Recognising Business Risks
- Protecting Your Business
- Potential Insolvency- The Options
- Budget 2011

Company or sole trader?

General Rule of Thumb:

If the net profits of the business are not in excess of the salary required by the business owner, a company is not usually recommended.

Company or sole trader?

- **Sole Trader - Key Points**
  - **Pros**
    - Relatively low set up and administration costs.
  - **Cons**
    - Unlimited Liability for debts of business.
    - Profits taxed at taxpayers marginal rate of tax (approx 50%).
    - Reduced options in relation to pension entitlements
    - Reduced options in relation to travel and subsistence.

Company or sole trader?

- **Limited Company- Key Points**
  - **Pros**
    - Personal assets are protected from creditors in the event that the business becomes insolvent and has to fold. This is a huge issue, particularly in the current trading environment.
    - Corporation tax is only 12.5% if the company retain profits over and above the salary required by the owner. For the first three years, the rate of corporation tax on any surplus may be 0% (subject to some limits – see later).
    - Certain reliefs/exemptions are only available to companies – see later
    - Potentially a more favourable treatment for subsistence and mileage expenses.
    - More flexibility and greater tax/PRSI savings for pension contributions. This is a very big current issue as the personal limits have fallen so much.

Company or sole trader?

- **Limited Company- Key Points**
  - **Cons**
    - Requirement to file a tax return for the company in addition to a personal tax return.
    - Requirement to file returns with the Registrar of Companies and comply with their deadlines, as well as ensuring that company law director obligations are met. Director loan accounts is a huge risk area.
    - Additional accountancy fees but may be audit exempt.

Employee Remuneration

- Practically all benefits provided to employees are subject to P.A.Y.E.
- Strict Revenue Guidelines in place for valuing every benefit in kind (B.I.K) provided.
- Significant obligations placed on employers to account for P.A.Y.E correctly on all B.I.K's provided.
- Revenue continue to police their B.I.K procedures through their Revenue Audit Process.

Employee Remuneration

Tax Efficient Remuneration Options

- Employer pension contributions.
- Legitimate travel and subsistence claims.
- Canteen Facilities
- Train/ Bus/Luas Annual Tickets
- Bike to Work Scheme

Employee Remuneration

Compliance Requirements

- Monthly P30’s to be filed by employer.
- Annual P35 to be filed by employer.
- New Employee Administration- Tax Credits & P45’s, emergency tax etc.
- Employee Cessations- P45’s and tax implications of final payment.
- Administration of B.I.K’s provided.

Tax cashflow ideas - general

- Pay and file online – extended deadlines
- Offsets possible? Statutory redundancy.
- Maximise relief or loss claims and seek offsets/refunds
- Interim refunds of tax – e.g. PSWT
- Tax-free expenses
- Grants or other supports?
- If genuine cashflow problems arise and you fall into tax arrears, try to negotiate an instalment arrangement with Revenue. Our experience has been largely positive on this front.

Tax cashflow ideas - VAT

- Should you be registered at all? Should you elect to register?
- Frequency of filing VAT returns – some options depending on whether in a payment or refund position normally
- Timing of VAT trigger point – date sales invoice 1^{st} rather than 31^{st}
- Are all input credits being claimed?
- Reclaim overseas VAT more quickly online via ROS
- Can you claim bad debt relief for VAT?
- Should you be on the cash receipts basis?
- If you purchase a CO2 efficient vehicle that will be used for at least 60% business purposes, you may be entitled to claim up to 20% of the input VAT incurred, subject to the normal deductibility rule.

Tax Reliefs

- In our experience there are several tax reliefs available to companies and individuals which are often not availed of by small and medium enterprises.
- These include the following:

1. Tax exemption for new companies

- Currently applies to certain new companies starting to trade in 2009 through 2011.
- Relief, if available, is for three years from start of trade.
- Reduces corporation tax to nil as long as corporation tax due is less than €40k (i.e. trading profits of less than €320k). Marginal relief applies for tax of up to €60k.
- Key concept is that of a “qualifying trade”, which, for example, does not include a trade already carried on **or** a profession (e.g. engineer, accountant, doctor)
- If the relief applies, could legitimately avoid paying corporation tax of up to €120k over three years
- Extension in 2011 linking relief to PRSI paid.

2. Seed capital relief

- Similar to Business Expansion Scheme (BES) in concept but shareholder claiming relief must also work for the company as it is designed to provide an incentive for individuals to start their own business
- Must invest for shares in a new company that carries on certain activities - e.g. primarily “manufacturing”, internationally traded services, and commercial R&D
- Can get an income tax refund over six years
- Maximum investment is €600k (€246k refund @ 41% rate)
- Husband and wife can each invest if meet conditions
- Qualifying conditions can be quite complex – EU rules
- State body input needed - e.g. County Enterprise Board

3. Accelerated capital allowances

- A taxpayer can claim an annual “wear and tear” allowance against income from a trade or profession.
- This yearly deduction is generally a percentage of the original cost of the asset bought for use in the business.
- In most cases, the rate of allowance for “plant and machinery” is 12.5%.
- Certain categories of “green” equipment now qualify for an accelerated **100%** rate of allowance
- Only applies to expenditure incurred by a company
- SEAI maintains a list of qualifying assets

4. R & D relief

- The research and development ("R&D") tax credit was first introduced in 2004
- Recent changes have made it far more attractive, particularly for start-up companies and those with corporation tax losses
- It is now possible to get a **cash refund** from Revenue in some cases.
- It seems that very few domestic or SME companies have actually made claims to date and a number of companies that qualify may be missing out on this valuable tax relief. A recent KPMG survey indicated that as few as 6% of SMEs have claimed it to date
- The definition of R&D is much broader than many realise, and covers much more than the traditional image of men in white coats or nutty professors with test tubes in labs.
- Examples include…
- See next slide

R & D Relief

- *(1) an activity undertaken in the field of natural sciences, namely—*
- *(d) earth and related environmental sciences, including geology, geophysics, mineralogy, physical geography and other geosciences, meteorology and other atmospheric sciences, including climatic research, oceanography, vulcanology, palaeoecology, and other allied sciences, or*

R & D relief

- For periods starting on or after 1 January 2009, the relief operates by allowing the claimant company a corporation tax credit equal to 25% (20% for earlier periods) of its incremental expenditure on qualifying R&D activities over the “base year” spending level.
- The “base year” has been set as 2003 indefinitely. Where a company had no such expenditure in 2003 or was incorporated after that, then the entire qualifying R&D spend in the current period will qualify for the credit.
- The 25% tax credit is in addition to the “normal” 12.5% relief so it is possible to get an effective credit of 37.5%.
- R&D relief **must** be claimed within 12 months of the end of the accounting period in which the spend was incurred or it is lost. This is of vital importance.

R & D relief

- The qualifying expenditure may be capital (e.g. a new building or machine) or revenue (e.g. salaries, materials). R&D and capital allowances may apply to the same asset
- Both direct and indirect (i.e. administration/other costs allocated on a reasonable basis) spend qualifies.
- Grant-aided expenditure does not qualify.
- The activities do not need to be carried out in Ireland.
- Though aimed mainly at in-house R&D activity, sub-contracted work also qualifies in some cases, subject to limits based on the level of in-house activity. The limits are 10% for third parties and 5% for third-level institutions

R & D relief

Example: Bunsen Burner Ltd.

Qualifying spend in year ended 31 December 2003 €100k
Qualifying spend in year ended 31 December 2009 €580k
Incremental spend in 2009 €480k
R&D credit (@ 25%) €120k

- If this company does not have enough of a corporation tax liability to fully/partially absorb the €120k credit, the directors can, from 2009, choose to have it repaid to the company in cash in equal instalments over three years if certain criteria are met – e.g. PAYE paid test.
- If the criteria can be met, this company (assuming it had no corporation tax liability, e.g. due to losses) could receive a repayment from Revenue of €40k each year for three years

R & D relief

- As you can see, a number of criteria must be met to be qualifying R&D activities for the purposes of the tax credit, which includes consideration of the areas of science and technology in which the work has been carried out.
- In addition to “obvious” areas where R&D is carried out (e.g. pharmaceuticals), software development, health, engineering, food production, and agriculture are just some of the areas where relief may be available. Others include natural sciences like geology.
- The breadth of activities likely to qualify means that several companies should, with careful analysis of the costs incurred on most R&D-type activities, be in a position to claim an R&D credit, which means either a tax refund or a smaller cheque to write for corporation tax.

Recognising the Risks

Management:

- Lack of Realistic Business Plan
- 1 man band? / Autocratic control
- Poor middle management
- Failure to change/ adapt new methods

Financial Information:

- Lack of appropriate information
- Lack of interest in information
- Accounting ratio’s: Which are relevant to your business?

Recognising the Risks

<u>Additional Risk Factors:</u>

- Over reliance on key client – Are all your eggs in one basket?
- Overexposure in a particular sector
- Unsustainable borrowings
- Excessive staff levels / inefficiency
- Poor cashflow / working capital & overhead controls

Know The Warning Signs of Financial Distress!

Early Warning Signs

- **Cash**
  - Overdraft max'ed
  - Cash reserves depleted
  - Relationship with bank is strained
- **Debtors**
  - Debtors days extending
  - Increased bad debts/ settlements
  - Credit limits reached

Early Warning Signs

- **Creditors**
- Stretch on creditor days
- Payment of creditors in round sum amounts
- Other Creditor pressure
- Substantial arrears accrued
- Revenue returns neglected

Early Warning Signs

- **<u>Other issues</u>**

Internal issues:

- Offices descend into disarray / disrepair
- High / rising staff turnover

Administration:

- Rise in legal disputes
- Qualified audit report

Market:

- Taking greater risks in the market
- Ageing product
- Increased competition

Protecting Your Business

Protecting Your Business

"By far the most common business mistake is not brought about by doing something, but by not doing anything"

Sir John Harvey-Jones

Former Chairman of ICI

Protecting Your Business

- Management information is vital – It should always be: *accurate*, *understandable*, *cost-effective*, *attainable*, *comparable*, *relevant and up to date!*
- Maintenance of books and records
- Accurate cash flow forecasts
- Crucial to have sound cashflow, working capital & overhead controls

Protecting Your Business

- Monitor/ Control your debtors' ledger –Recurring deficiencies include:

  - ⇨ Lack of copy invoices, Lack of confirmed purchase orders, Lack of signed delivery dockets and Lack of terms & conditions of trade

- Protect your assets as best you can e.g.:

  - Retention of Title Clauses

  - Credit Insurance

- Utilise appropriate professional advice:

  - Allows a 3rd party perspective

  - Balance between accounting / legal advice

Be Alert To Signs of Customer Distress

- Has the customer changed bank?
- Are the Signatories/Directors changing?
- Is there a change in payment pattern? Are you receiving part-payments / post dated cheques?
- Customer raises spurious queries
- Customer insists on paying COD / Slow in providing relevant transaction documents
- Customer won’t return calls/ can’t be contacted
- Industry rumours
- Customer premises are in disarray / disrepair

Protecting Your Business

***Revenue Commissioners*:**

- It is crucially important to make timely returns/ payments.

- Keep the Revenue informed of your position if you are struggling.

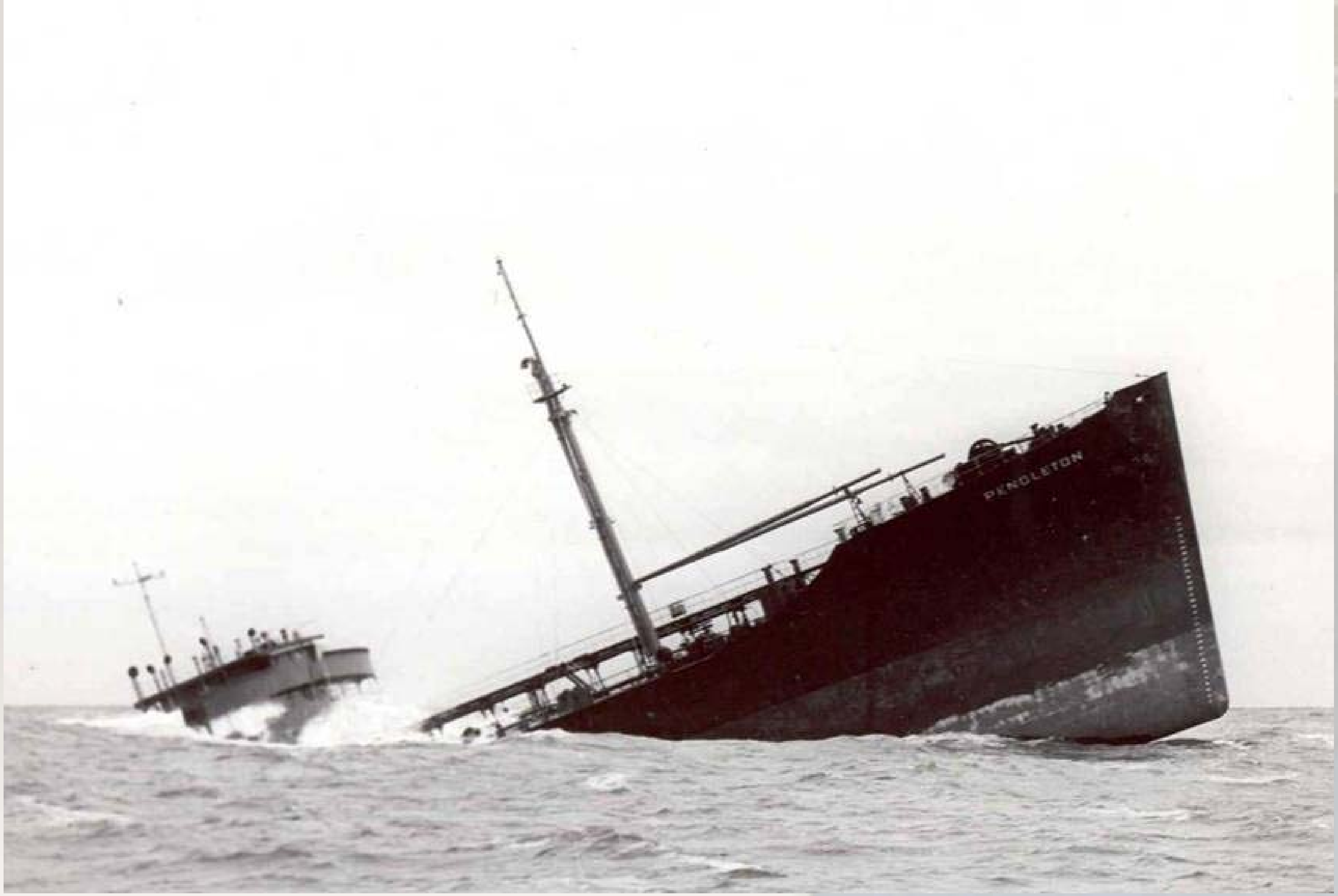
- Revenue Commissioners will act on foot of unpaid taxes:

  - Attachment Orders

  - Revenue Sheriff

  - Winding Up Petitions

Insolvency



What is Insolvency?

- No universally accepted definition – There are **2** main tests:

  Balance Sheet Test: Do the Company's assets cover its liabilities?

  Cash Flow Test: Can the Company continue to pay its debts as they fall due?

- An insolvent position is not necessary terminal – there is scope for recovery providing the actions taken are reasonable.

Insolvency

If your business is insolvent and has no reasonable prospect of recovery then:

– Seek relevant legal and financial advice

– Preserve assets for benefit of all creditors

– **Do not** incur any further credit

– **Do not** make any payments other than justifiable payments associated with preserving assets (Insurance, Security, Utilities)

– **Do not** dispose of assets

Insolvency Options
Behind the Jargon

Members' Voluntary Liquidation (MVL)

Creditors' Voluntary Liquidation (CVL) — Winding up

High Court Liquidation (HCL)

Receivership — Enforcement

Scheme of Arrangement

Examination — Alternatives to winding up

Insolvency Options
(1) Creditors Voluntary Liquidation

- Directors resolve that the Company is insolvent and convene an EGM to ratify the decision to wind up the company, review a statement of the company's affairs and convene a meeting of its creditors.

- All creditors must receive at least 10 days notice of the proposed creditors meeting which must also be advertised in newspapers.

- The Directors/Shareholders proposed liquidator can be overturned by a majority vote at the Creditors meeting.

- The Liquidator will report to the ODCE on the Directors' conduct to the ODCE – This includes all current directors and those within previous 12 months.

- Typically the process will last 1 year +.

Insolvency Options
(2) High Court Liquidation

- A Petition seeking to have the Company wound up is presented to the Court - Grounds for the Petition Include:
  - An Unpaid Debt (Ref: S214 Cos Acts 1963)
  - The Oppression of Members
- The Petitioner is usually a Creditor of the Company – although Company Directors and a number of other parties can also petition.
- The Court will grant a date for hearing the Petition at which (If successful) an Official Liquidator will be appointed.
- In certain cases the Court may appoint a ‘Provisional’ Liquidator to the Company in the period between the Petition’s presentation and hearing dates.

Insolvency Options
(2) High Court Liquidation

- Interested parties can have their say on the matter at the hearing of the petition and should receive due notice of the hearing.
- The costs of petitioning for a winding up are typically €8k+, However these costs can be fully recovered if the Liquidator can realise sufficient assets.
- The Liquidator will report to the ODCE on the Directors' conduct – This includes all current Directors and those within previous 12 months.
- Typically the process will last 1 year +.

Implications of Liquidation

- Company normally ceases to trade with immediate effect and all staff made redundant

- Directors' lose all power and control – Liquidator is in complete charge of the business and its assets

- Valuable assets may be forfeited e.g. leasehold premises

- Personal guarantees may be enforced

- Directors are obliged to co-operate with Liquidator's investigation into the Company's affairs

Insolvency
Payment of Creditors

- In CVL and HCL the Ranking of Creditors in the event of Liquidation is as follows:

  - Fixed Charge Holders – e.g. Banks
  - Preferential Creditors – e.g. Revenue, Rates & DETE
  - Floating Charge Holders – e.g. Banks
  - Unsecured Creditors – Normally You!

- The Liquidator is usually paid in priority to all other creditors (except for example in HCL where the costs of the petition will rank 1^{st})

- The Liquidator will make distributions to various creditor classes depending on the amounts realised from the Company's assets. The time scale for such distributions can be years!

Alternatives To Winding Up
(1) Schemes of Arrangement

- <u>Formal (Section 201 Companies Acts 1963 – 2006):</u>
  - 75% of Creditors / class (by value) must accept proposed scheme.
  - Can be enforced by Court

- <u>Informal Schemes</u>
  - Flexible and choose which Creditors to negotiate with.
  - Entirely dependent on relations with individual creditors.
  - Individual settlements / time frames.

Alternatives To Winding Up
(2) Examinership

- Not suitable for everyone; there are strict Criteria e.g:

  - Company must have reasonable prospect of survival

  - Creditors must be better off than in the event of insolvency

  - Company must be able to pay debts as they fall due after the appointment of the examiner (from new investment or cashflow)

Alternatives To Winding Up (2) Examinership

- The Examiner will formulate a Scheme Of Arrangement whereby certain / all of the Company's creditors will receive a portion of their debt in full and final settlement.

- Only **1** class of creditors need to accept scheme in order for Court to ratify it – Though in practice such a scheme is unlikely to receive Court approval.

- The Company is usually responsible for administering the scheme once it is ratified by the Court.

- Examinership can be a ***costly*** process with no guarantee of success.

Implications of Examinership

- Pre-examinership litigation is stopped in its tracks
- The Examiner normally has no executive function in the Company – Directors' retain day to day control.
- Allows a 'breathing space' to focus on your business - Company is protected from its creditors by the Courts for up to 100 days
- Pre-examinership debts can be drastically written down in the Scheme of Arrangement
- Certain potential claims against the Company can also be provided for, included in the Scheme of Arrangement and written down in advance

Receivership

- A Receiver is normally appointed by a debenture holder on foot of a fixed/ floating charge
- The Receiver's purpose is to secure and realise the charged asset(s) in order to discharge the liability due to the debenture holder
- It is possible for a business to continue to trade whilst in Receivership however the appointment of a Receiver is usually very damaging
- Appointing a Receiver is usually an option of last resort – particularly in the current climate as market re-sale values have fallen
- A Receiver can expelled by the appointment of an Examiner / Liquidator

Conclusion

- ✓ **Be aware** of the risks to your business, the early insolvency warning signs and the condition of your customers.

- ✓ Protect your business, your assets and **reduce your exposure** where possible

- ✓ **Early action is vital** – Avoid ‘ostrich syndrome’! Situations can be reversed!.

- ✓ Don’t be afraid to **seek professional advice**.

Budget 2011

- Corporation Tax Rate of 12.5% maintained.
- Stamp Duty on all residential property reduced to 1% (2% applicable over €1m)
- Removal of €75,036 CAP for employee PRSI contributions.
- Income Levy and Health Contribution replaced by single Universal Social Charge

Budget 2011 (Cont'd)

- Tax Free Pension Lump Sum capped at €200,000
- Tax Free Termination Payment Capped at €200,000
- Start up company exemption continued
- New BES Scheme due in 2013-Limits increased in the interim.
- Property Reliefs-Severe Restrictions

Budget 2011 (Cont’d)

- Relief for interest on loans to acquire shares in trading companies abolished and relief for existing loans to be phased out.
- Tax Credits and Rate bands decreased by 10%.
- VAT rates will continue to rise.

Questions ?

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