A newsletter from NIFA
APPROVED EXPERT FINANCIAL WITNESSES

NIFA NEWS

ROI ISSUE 17

NIFA IS PLEASED TO WELCOME FOUR NEW MEMBERS

David Adamson	• Adamson Forensic Accounting Ltd	• Edinburgh
Shaun Walbridge	• SW Forensic Accounting Ltd	• Plymouth
Martin Jackson	• Jackson Calvert	• Sutton Coldfield
John Kenny	• Providence Forensic Accounting Experts Ltd	• Wicklow

NIFA BBC CALL ON NIFA'S EXPERTISE IN FAREPAK COLLAPSE

The BBC called on NIFA member David Winch for comment on the Farepak collapse in an interview that was broadcast on BBC1 on the 4th December 2006. The interview was also documented on the BBC's news website. http://news.bbc.co.uk

NIFA Tax and divorce

Too often the accounting experts are appointed too late to make a difference to the financial settlement. Too often the accountant is asked merely to value the spouse's shares in ABC Ltd and only later asked, as an afterthought, how to extract funds from the company. With a bit more upfront involvement, the accountant can help to ensure that the divorcing couples safeguard their marital assets for themselves, with the legal minimum amount of tax going to the Revenue Commissioners.

Advance warning is needed if tax avoidance is to be undertaken professionally and successfully. A company buyback of its own shares takes time to complete — prior approval from the Revenue Commissioners under section 176 TCA 1997 is necessary and, the legal documentation and filings at the Companies Office require professional preparation and time for filing. The entire transaction must be well reviewed to ensure that it is tax efficient and properly accounted for.

Before separation

The best tax plan is to pay no tax whatsoever while complying with the law. Transfer of any property between spouses is exempt from capital gains tax. The spouse acquiring the asset takes the cost and duration of the ownership of the other spouse. Where possible the separating couple should try to ensure that transfers are effected prior to the granting of the divorce order. In the absence of this, the same reliefs will apply if disposals between divorced spouses are made pursuant to a court order. Careful planning at this stage however can avoid unpleasant tax shocks many years down the line when shares are being disposed of either to a third-party or to children of the marriage. Foresight and collaboration by the separating couple can help ensure that the family assets are preserved to facilitate the maximum settlement for both.

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Avoiding tax by gifting assets

A total exemption from capital acquisitions tax is provided in respect of gifts taken by a donee who at the date of the gift is the spouse of the disponer. It is important therefore to ensure before the divorce order is made, that all adjustments with regard to family and business assets are completed.

Income tax

Maintenance for both the spouse and children of the marriage should be carefully reviewed subject to the overriding legal necessities of a spouse who has been the principal care provider to the children of the family so that income tax credits and the standard rate tax band can be used to maximum effect on the spouses maintenance payments with the balance being payable to the children. This is always a complex area into which a great deal of effort in planning must be put to take account of proper provision and the likelihood of the principal care provider either gaining employment in the future or remarrying.

Stamp duty

There is no liability for stamp duty in respect of property transferred from one spouse to another even if they are separated.

NIFA Extracting funds in a tax efficient manner

So how can we get funds from the company in a tax efficient manner?

The simplest route is if the spouse is a director and has lent money to the company. His/her director's loan account would be in credit. He/she can draw funds from the company up to the amount standing to the credit of the loan account without tax consequences. If the company does not have sufficient funds, it may be possible for the company to borrow funds to enable it to repay the loan account.

Earnings from employment

Any funds paid out of the company for the benefit of an employee, director (other than a repayment of a loan made to the company), or shareholder are subject to tax. Thus, paying a director a higher salary will result in the director suffering more income tax and levies (probably at 47%). On its own this is not very tax efficient, but if the director is also disposing of his/her shares, and retiring from the company it may be possible to combine this payment with an uplift in pension premium payment into the companies pension fund, and pay a terminal bonus (tax free to the individual) which are deductible from the company's profits. Most additional payments may require a board minute which should not be a problem in the case of a family company with two shareholders.

Dividends

Dividends are the least tax efficient method of withdrawing funds from a limited company as there is no deduction for corporation tax. Drawings from a sole trader ship or partnership are treated differently and are not of themselves the subject to tax as only profits of the entity are assessed.

Pension premium payments

Payments by a company into its pension fund for the benefit of a named individual can be made in significant lump sums subject to review and approval by the Revenue Commissioners based on the individual's salary and employment history with the company. If the individual is close to retirement age this can represent a significant tax free payment in his/her hands, subject to restrictions on cash uplift. Similarly a lump sum payment from a sole trader ship or partnership into a pension fund has the same effect and both are deductible for tax purposes.

Terminal bonus - for full time directors

Subject to a number of conditions with regard to the length of service, salary, shareholding etc this is a valuable route for extraction of funds tax free in the hands of the individual. With a judicious adjustment of salary in the final year (subject to PAYE/PRSI) the value of the terminal bonus can be significantly increased. This terminal bonus is tax free in the hands of the individual.

Loans

An unincorporated business may borrow money that can be on lent to a partner/proprietor. Care should be taken to ensure that the borrowings are not such as would give rise to a restriction of the deductibility of interest against the taxable profits of the business.

Borrowings from a limited company are effectively prohibited under the companies act with some tightly controlled exceptions. The most negative aspect of these borrowings however is that they will give rise to an assessment equivalent to Income Tax under the Corporation Tax Act.

Sale of assets and sale and leaseback

Where a business has assets that are surplus to its requirements such as plant and machinery or property that is no longer fully utilized, it can be sold off for development. While selling such assets will have a tax implication in respect of income tax or corporation tax for plant and machinery and capital gains tax in respect of the land or buildings, the net cash generated can free up funds to facilitate settlements in divorce and separation.

Aggressive tax avoidance

Under our current tax administration system this approach is not for the fainthearted as there are considerable risks loaded against the taxpayer in favour of the Revenue Commissioners. Schemes are being overturned on the basis that they do not have a reasonable commercial focus. The combination of tax, interest and in some cases penalties set odds against the taxpayer that most bookies would blush at. Protective notifications are sought by the Revenue Commissioners under section 811 A of the Taxes Consolidation Act 1997 for all transactions to avoid liability to tax. While failure to send the relevant form PN1 does not constitute a revenue offence, it is made clear in the legislation that tax, interest, and penalties may apply if the transaction is deemed by the Revenue Commissioners to be a transaction for the purpose of avoiding tax.

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Company buy-back of shares

This is a useful and practical means of extracting funds tax efficiently. Instead of the spouse having to find cash personally to pay the other spouse, the company can buyback the shares from the departing spouse. This presupposes either cash or readily saleable surplus assets in the company to fund the buyback and is dependent upon one of the spouse/shareholders departing from the business. In addition to the Companies Act requirements, which must be professionally approached, a number of preconditions apply to avoid the payment being treated as a distribution subject to Income Tax.

These are:

- *Where an unquoted trading company buys back its own shares from a shareholder the payment made to the shareholder is not treated as a distribution provided:*
- *The acquisition of the shares by the company is wholly or mainly for the benefit of the trade.*
- *The shareholder is resident and ordinarily resident for the year of assessment in which the shares are acquired by the company.*
- *The shareholder has owned the shares throughout a five year period ending with the date of the buy back. Bonus issued shares or shares acquired by a company reorganisation, reconstruction or amalgamation are treated as having being acquired at the same time the original holding was acquired.*
- *The buyback must not be part of a scheme or arrangement the purposes of which is to enable the shareholder to participate in profits without receiving a dividend.*
- *The vendor's shareholding in the company must be substantially reduced.*

The trade benefit test noted above is carefully scrutinised by the Revenue Commissioners using form AOS1 which must issue to them in respect of every buyback of company shares.

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