BAKER TILLY
RYAN GLENNON

Growth Strategies for SMEs

Brian Hyland – June 2013

Contents

Business Growth

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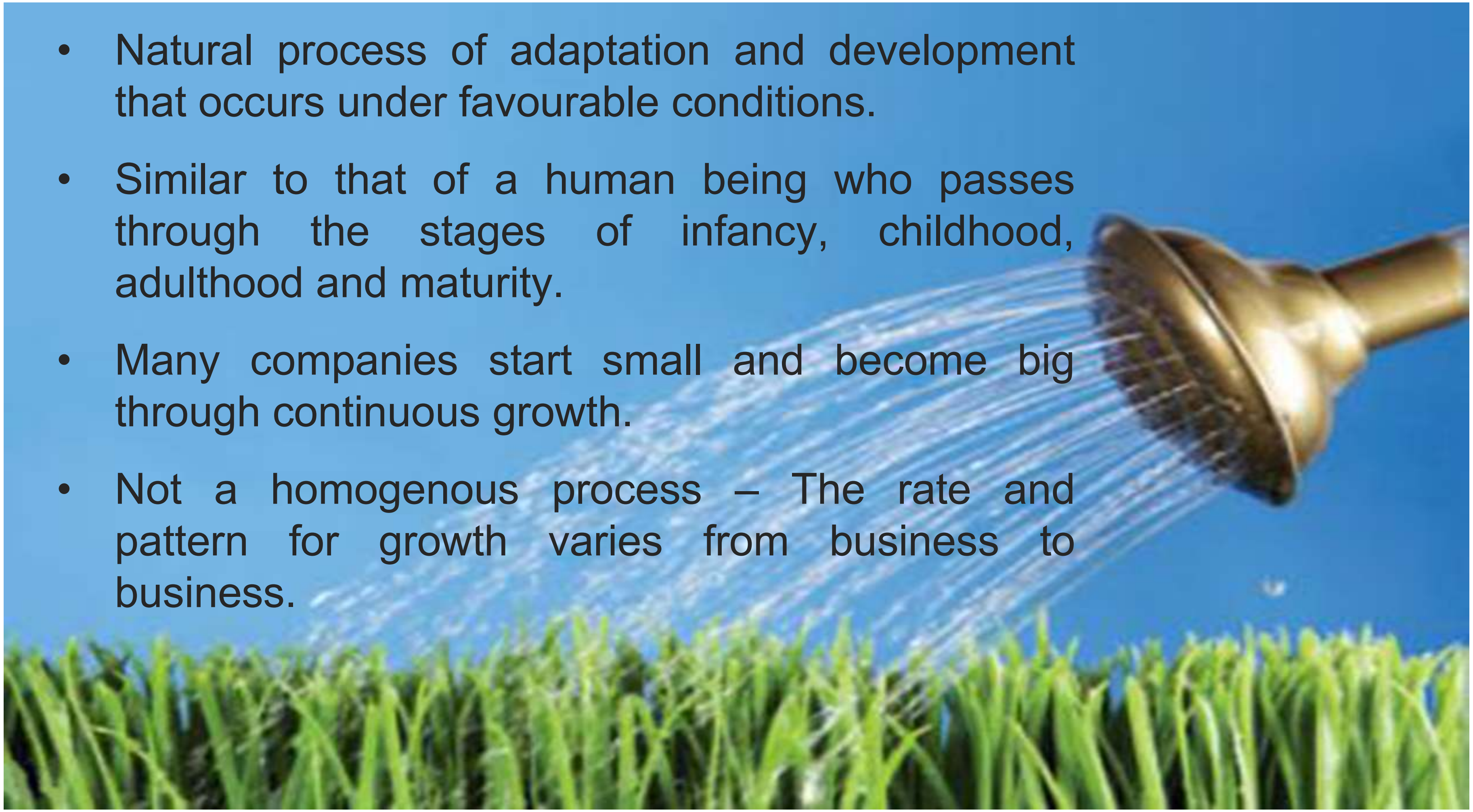
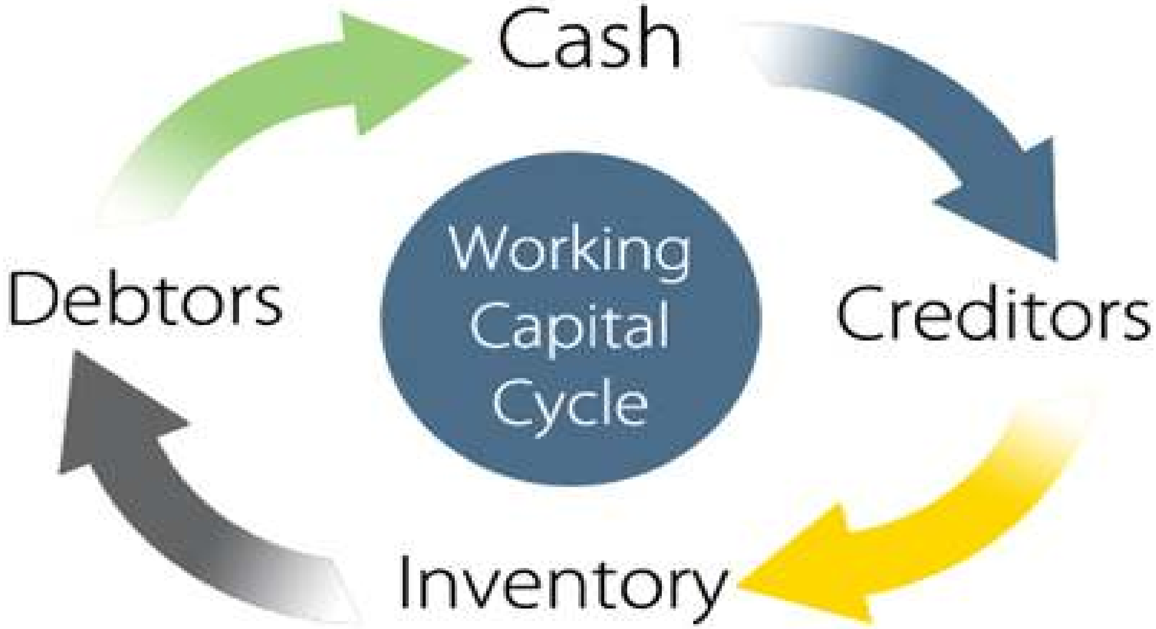


- Natural process of adaptation and development that occurs under favourable conditions.
- Similar to that of a human being who passes through the stages of infancy, childhood, adulthood and maturity.
- Many companies start small and become big through continuous growth.
- Not a homogenous process – The rate and pattern for growth varies from business to business.

1. Constraints to Business Growth

Virtuous Cash Cycle



1. Constraints to Business Growth

Constraints to Business Growth

Finance	Market	Human Relations Problems
Growth, especially external growth, requires additional capital investment which is sometimes difficult for a small firm to arrange.	Growth can be achieved to the extent that the size of the market permits. If a business grows faster than the increase in the size of the market, it is likely to face failure.	As a firm grows, management can become detached and loose the personal touch with employees and customers. Without proper systems and processes motivation and morale can suffer resulting in inefficiency.

1. Constraints to Business Growth

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Working Capital / Overtrading

•Overtrading often occurs when companies expand their own operations too quickly (aggressively).

•Overtraded companies enter a negative cycle, where an increase in interest expenses negatively impacts net profit, which leads to less working capital, and that leads to increased borrowings, which in turn leads to more interest expenses and the cycle continues.

•Overtraded companies eventually face liquidity problems and / or run out of working capital.

2. Growth Strategies

- **Organic Growth -v- In-Organic Growth**
- Growth measured in terms of increased revenue, profits or assets.
- Can choose to build in-house competencies, invest to create competitive advantages, differentiate and innovate in the product or service line (Organic Growth);
- Or leverage upon the market, products and revenues of other companies (In-organic Growth).
- Business expansion with the help of core-competencies and sales refers to Organic Growth and is in contrast with In-organic growth approach where expansion objectives are met through Mergers and Acquisitions (M&A).

2. Growth Strategies - Organic

Companies growing organically not only measure their success on financial metrics alone but take note of other metrics like:

- Customer Satisfaction Metrics
- Product Quality Metrics
- Logistics & Supply Chain Metrics etc.

2. Growth Strategies – In-Organic (External)

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Increasing output and business reach by acquiring new businesses by way of mergers or acquisitions.

Provides the following benefits:

- Helps reduce competition in the market place
- Instantly adds new brands and product/service lines
- Provides access to fresh customer base and adds new geographical locations and in many cases, an established marketing channel
- Economies of scale are achieved over a period of time
- A fresh breath of management skills (fresh blood)
- Time-to-market is substantially reduced which gives businesses a significant competitive edge

2. Growth Strategies

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Why In-Organic Growth (External)

•Industry and economic factors play a crucial role

•Slowing industry growth rate, fragmented industry and too many competitors fighting for the same market share

•An economic slump creates opportunities for cash rich companies to get hold of unutilised capacities of loss making competitors at attractive valuations.

2. Growth Strategies

- The following are strategies for external growth:
  - Merger
  - Acquisition
  - Takeover
- Differences between strategies often emerge in aftermath of process

3. Mergers & Acquisitions - Merger

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- Two businesses of similar value are combined under common ownership.
- Generally categorised as either upstream, downstream or lateral.
  - Upstream merger – smaller company seeks out larger company and is acquired by it;
  - Downstream merger – larger company seeks out and acquires smaller company; and
  - Lateral mergers are the combination of equals
- Normal for senior management positions in new, merged entity to be shared roughly equally between the managements of the two constituent firms, taking account of skills.
- Negotiations involve the relative ownership interest each company will hold in the merged entity.

3. Mergers & Acquisitions - Acquisitions

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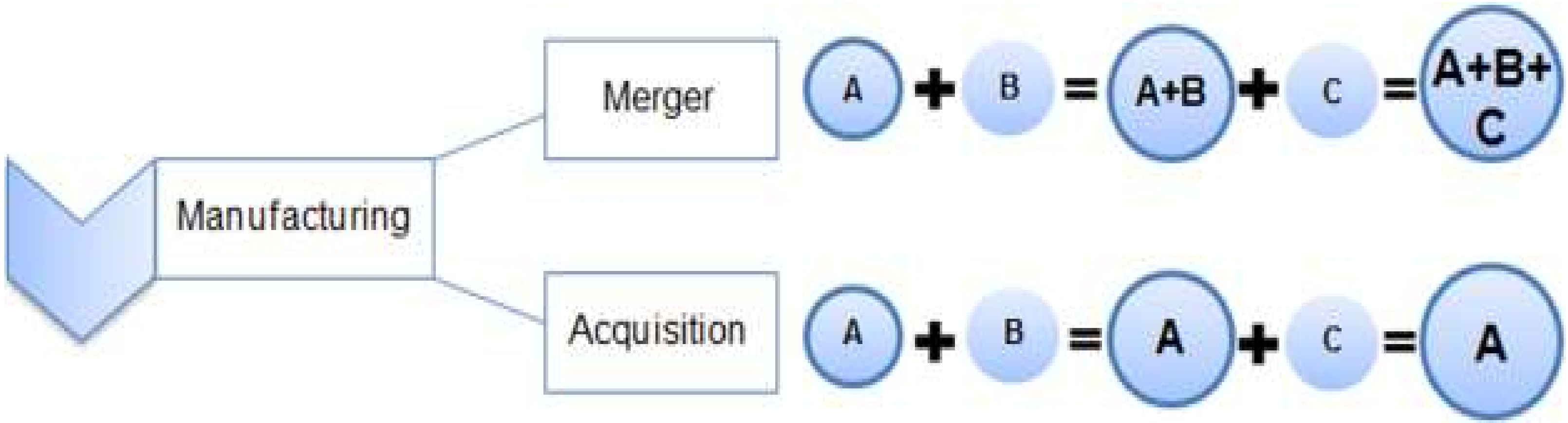
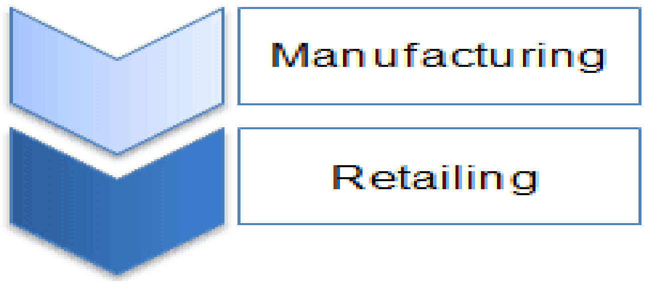
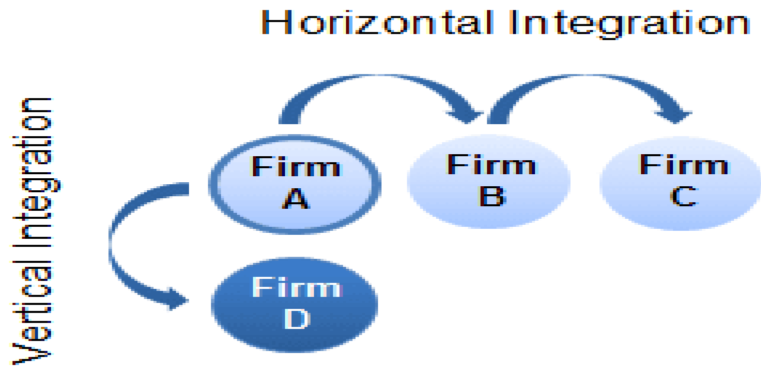
- Negotiations focus on the relative value of each company in negotiating a purchase price.
- Implication is that while merged companies operate on a cooperative basis, an acquisition involves absorbing part or all of another company.
- Especially true concerning acquisitions of companies in the same industry.



3. Mergers & Acquisitions

Mergers & Acquisitions generally fall under two categories:

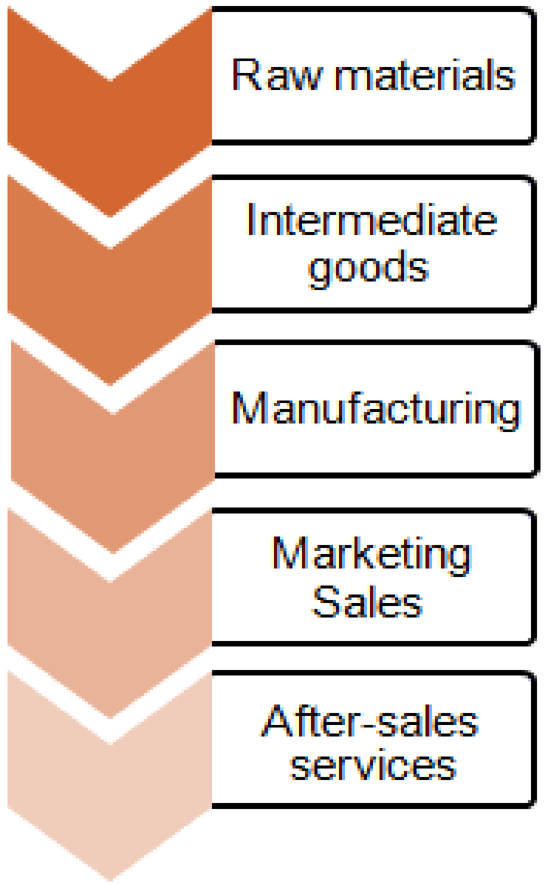




1. Vertical Integration
2. Horizontal Integration

3. Mergers & Acquisitions – Vertical Integration

- Most common type of integration - Allows a firm to gain control over its suppliers or distributors in order to increase power in the marketplace, reduce transaction costs and secure supplies or distribution channels.
- A company integrates with another in the same industry but at different stages of the production cycle to create an extension of the supply chain.



3. Mergers & Acquisitions – Vertical Integration

Example of vertical integration:

Smartphones Industry

Design
Apple, Huawei, HTC, Sony, Nokia & Samsung

Software
Apple, Google, RIM & Microsoft

Manufacturing
Flextronics, Foxconn, HTC, LG, Samsung & other OEMs

Marketing and Sales
Apple, Huawei HTC, Sony, Nokia & Samsung

After-sales services
AT&T, Verizon, Virgin, China Mobile, Vivo, Vodafone

Automotive Industry

Raw materials
ArcelorMittal, Baosteel, POSCO, Nippon Steel

Components
Denso, Bosch, Aisin Seiki, Continental, Magna, Hyndai

Assembly
Ford, GM, Hyundai, Nissan, Toyota, Volkswagen

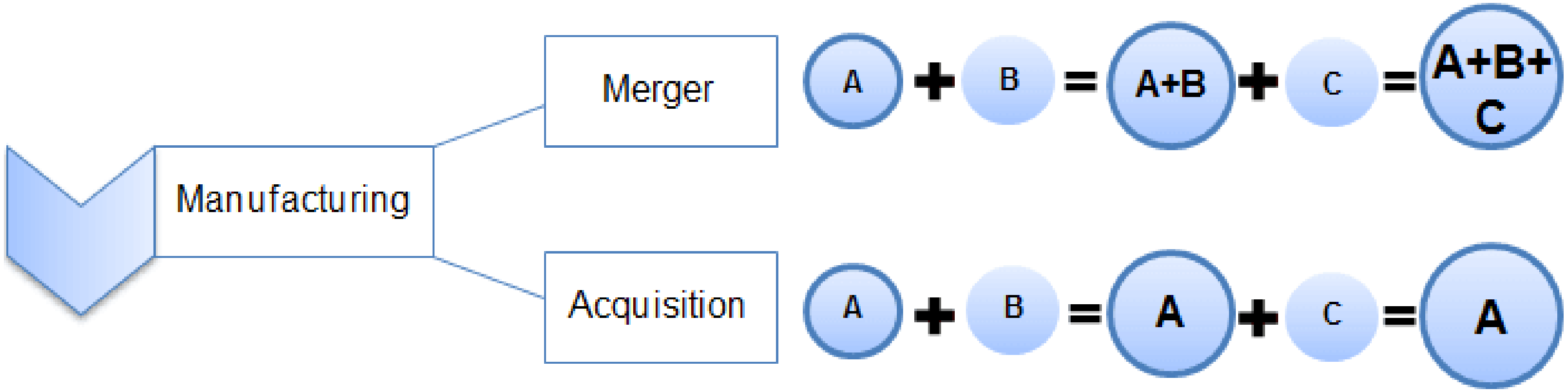
Importing/Exporting
Ford, GM, Hyundai, Nissan, Toyota, Volkswagen

Marketing and Sales
Ford, GM, Hyundai, Nissan, Toyota, Volkswagen

3. Mergers & Acquisitions – Horizontal Integration

- Strategy where company acquires or merges with another company in the same industry.
- Pursued by a company in order to strengthen its position in the industry.
- A company that implements this type of strategy usually **merges** or **acquires** in the same production stage.

For example, Disney merging with Pixar (movie production).



3. Mergers & Acquisitions – Horizontal Integration

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- New combined entity may be in a better competitive position than the standalone companies that were combined to form it.
- Goal of horizontal integration is to create a new, larger organisation with more market share.
- Because the integrating companies' business operations may be very similar, there may be opportunities to join certain operations, such as manufacturing, and reduce costs.

Acquiring company	**Acquired company**
Porsche	Volkswagen
Kraft Foods	Cadbury
Glaxo Wellcome	SmithKline Beecham
HP	Compaq
United Airlines	Continental
Microsoft	Yahoo!

3. Mergers & Acquisitions - Advantages

Synergies

•Can the two companies together be stronger and more profitable than either company was previously?

•May have a significantly higher value when combined than when operating apart.

•Two firms which manufacture and distribute into a shared market should significantly increase efficiency and reduce costs.

3. Mergers & Acquisitions – Economies of Scale

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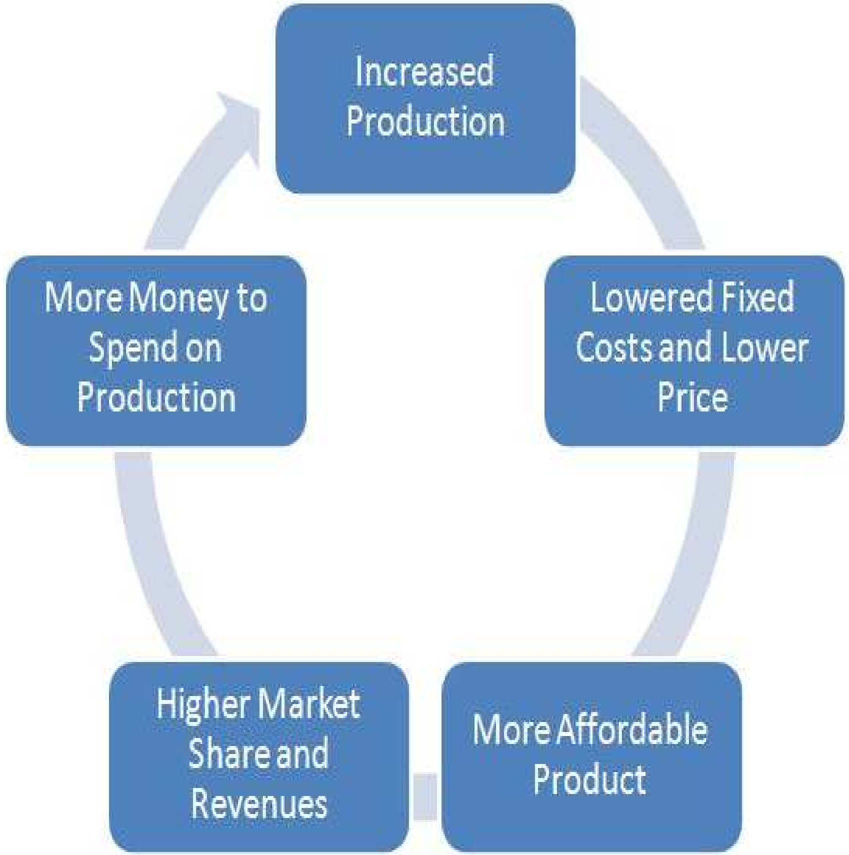
- Larger companies with greater market shares can reduce their unit operating costs to levels below those of smaller, less efficient rivals.
- Production economies of scale are obvious in an merger / acquisition.
- Undeniable benefits of scale will be realised when a production facility is suddenly operating at say 85% of capacity rather than 50%.



- Economies of scale don't end with production – also come into play in marketing, administration, professional expertise etc.

3. Mergers & Acquisitions

International Competition

•Can help firms deal with the threat of multinationals and compete on an international scale.

Technical Advantage

•In sectors with fast changing technology (e.g. mobile phone handheld devices or biotechnology), large operators may wish to use their greater cash resources to secure a technical or copyright advantage by acquiring smaller companies which have made a breakthrough.

•In this way they protect their own technical or market position while potentially thwarting rivals.

3. Mergers & Acquisitions

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Accelerate the winning of market position

•Merger / Acquisition offers a much quicker gain in market share compared to establishing a new Greenfield operation.

•Market position may be more cheaply acquired by merging with / purchasing an incumbent operator than by starting afresh and building up a market position from scratch.

Allow greater investment in R&D

•The new firm will have more profit which can be used to finance risky investment – can lead to better quality of goods for consumers.

3. Mergers & Acquisitions

<u>Protect an industry from closing</u>

•Beneficial in declining industry where firms are struggling to stay afloat.

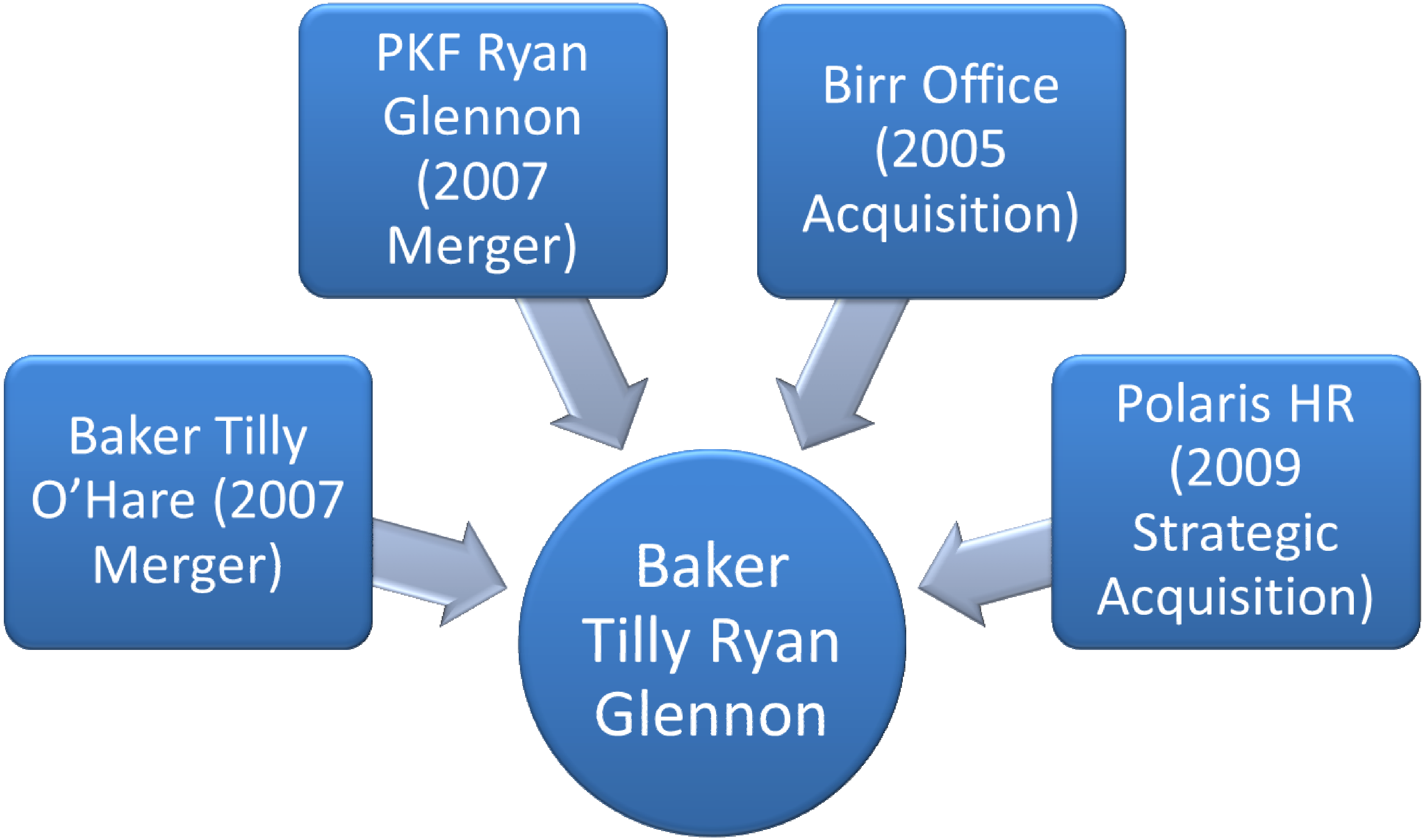
<u>Diversification</u>

•Sharing knowledge which might be applicable to the different industry.

•For example, AOL and Time-Warner merger hoped to gain benefit from both new internet industry and old media firm.

3. Mergers & Acquisition

Baker Tilly Ryan Glennon Journey



3. Mergers & Acquisition

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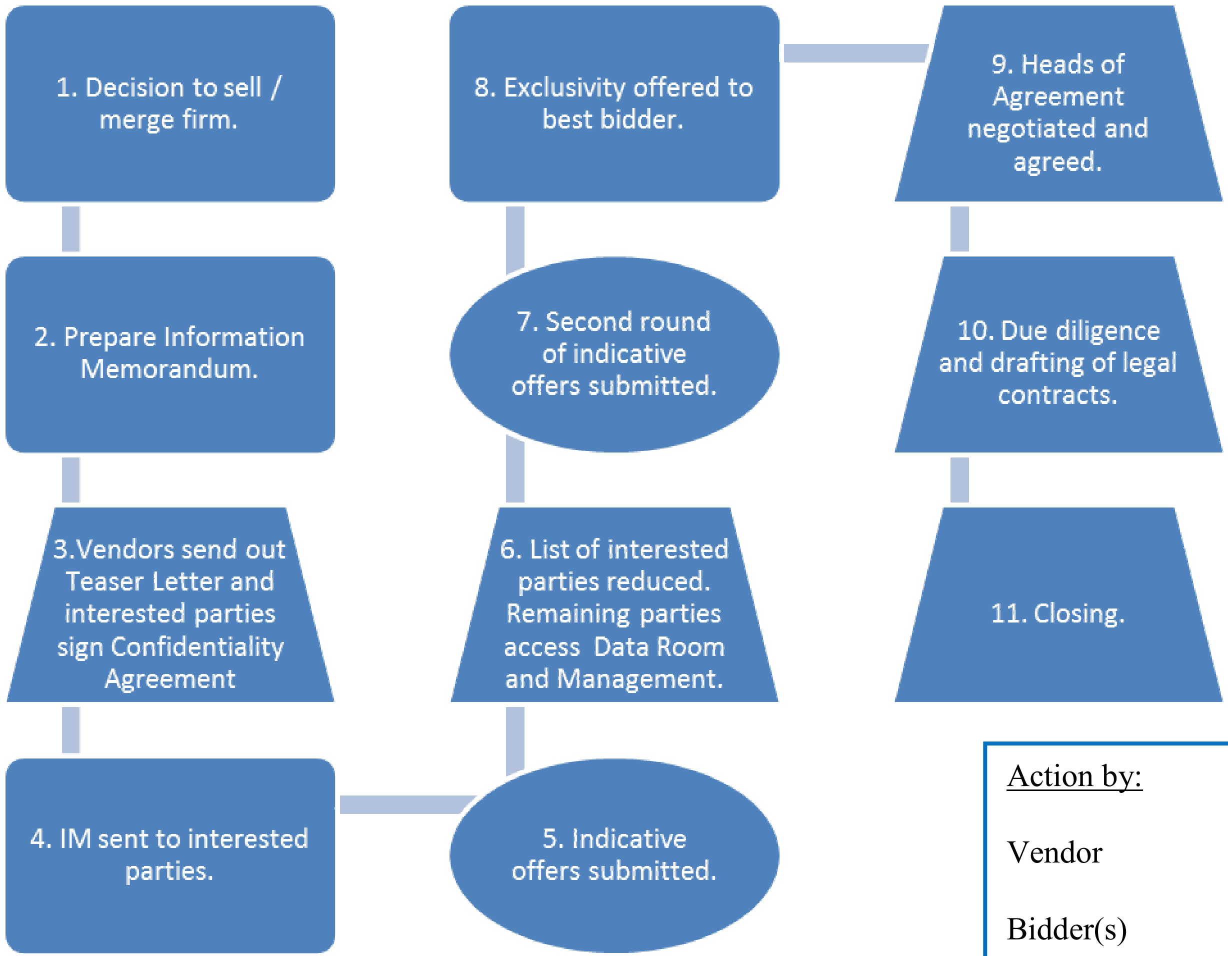
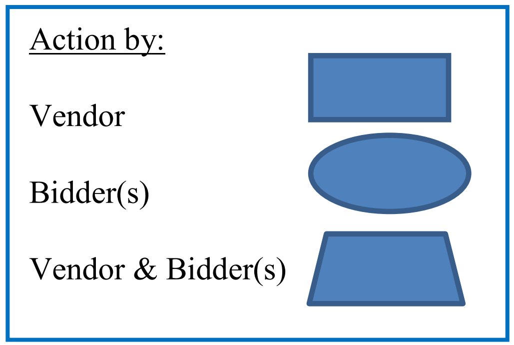
Key steps





3. Mergers & Acquisition - Risks

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Return on Investment

•The wrong acquisition can severely harm a company's profitability.

Corporate Integration

•Poor integration

•Company culture clashes (as in the Daimler Benz-Chrysler merger where German efficiency met head-on with American union work rules).

•Loss of important customers who liked doing business with the old company

•The solution is detailed planning and testing of decisions, with a centralised integration management team that monitors every element of the project.

3. Mergers & Acquisition

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Legal Surprises

•No matter how careful the due diligence effort, nearly every merger and acquisition experiences legal surprises.

•Often in the form of lawsuits that the plaintiffs suddenly decide to file because the combination of companies has presented greater assets to attach.

- An example of such cases include:
  - Expiring patents
  - Cancelled licenses
  - Unreported fraud
  - Infringement on another company's patent and shareholder class action suits.

4. Strategic Alliances/Joint Ventures

- Another means of achieving growth is through the formation of strategic alliances with other firms.
- Types of strategic alliance include:
  - Joint Ventures
  - Franchising
  - Licencing
  - Subcontracting; and
  - Networks.

4. Strategic Alliances/Joint Ventures

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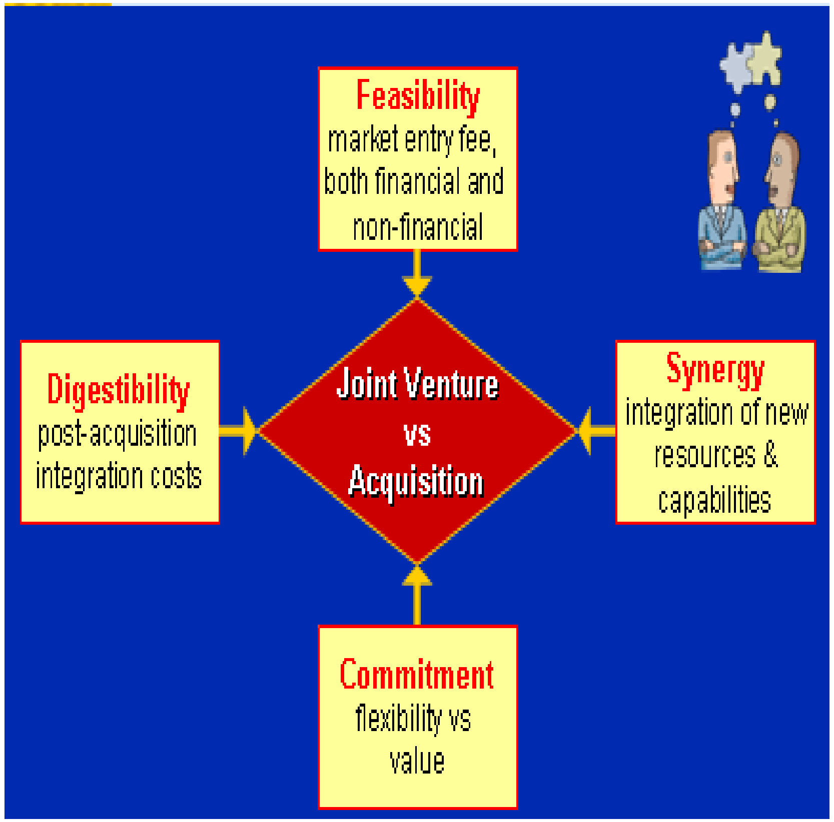
Joint Venture

•A business arrangement in which two or more parties agree to pool their resources for the purpose of accomplishing a specific task.

•Task can be new project or other business activity.

•Each of the participants is responsible for profits, losses and costs associated with it.

•Venture is its own entity, separate and apart from the participants' other business interests.



4. Strategic Alliances/Joint Ventures

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Franchise

•A license that a party (franchisee) acquires to allow them to have access to a business's (the franchisor) proprietary knowledge, processes and trademarks in order to allow the party to sell a product or provide a service under the business's name.

•Business arrangement in which two or more parties agree to pool their resources for purpose of accomplishing a specific task.

•Franchise, the franchisee usually pays the franchisor initial start-up and annual licensing fees.

•One of the biggest advantages of purchasing a franchise is that you have access to an established company's brand name – no need to spend further resources to get name and product out to customers.

4. Joint Ventures/Strategic Alliances -Advantages

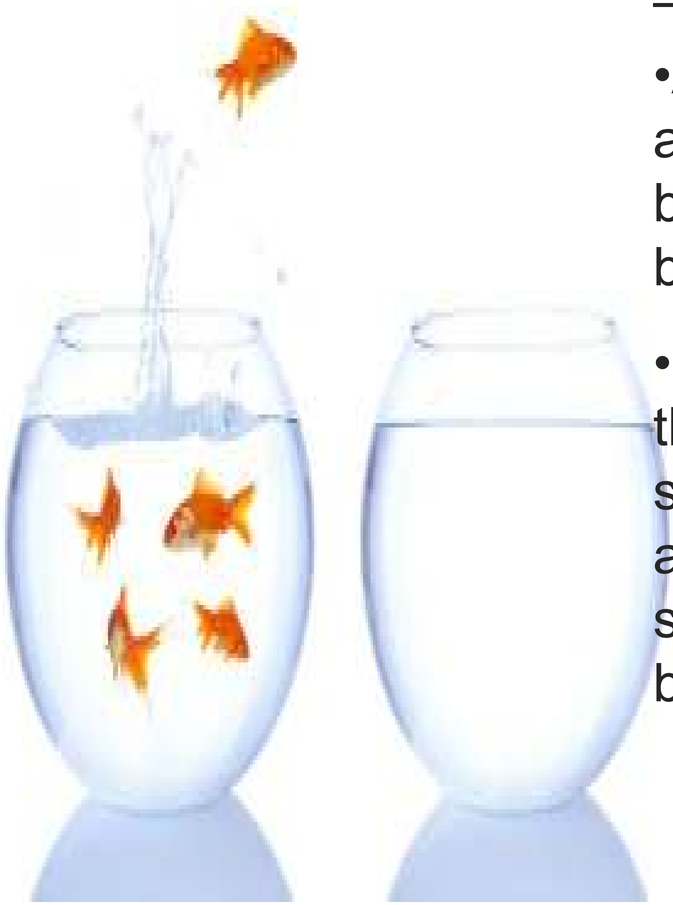
Access to Supplementary Services

•Opportunity to offer supplementary services to clients that otherwise would not be available.

•Vital to a business' success to focus on its core competencies because when a business becomes a jack of all trades, it becomes a master of none.

•Allows a company to offer its clients a whole new realm of services without losing focus on its capabilities and its specialized services.

4. Joint Ventures/Strategic Alliances - Advantages



Opportunity to Reach New Markets

•Automatically increase awareness of a brand among an entirely new market that the business has not had the resources to reach beforehand.

•In most cases a partner will be a business that offers a completely different set of services to a market that is similar to its own, allowing the business to increase its market size with little impact on the franchise business.

4. Joint Ventures/Strategic Alliances - Advantages

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Increased Brand Awareness

•Opportunity to grow market size with a partnership presents the opportunity to increase awareness of the brand.

•One of the key elements of a business' success is constant, growing brand awareness. If your brand awareness isn't growing, your business isn't growing. Strategic alliances allow an organisation to reach a broader audience without putting in additional time and capital.

Access to New Customer Base

•A franchise business is constantly searching for new, creative ways to increase clientele and reach new potential customers. Forming a strategic alliance provides an opportunity to do that.

•Trusting, solid business partnership will provide access to a completely new customer base

4. Joint Ventures/Strategic Alliances – Issues to be considered

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<u>Choosing the Right Partner</u>

•Choosing the wrong partner can be damaging if not able to contribute to the growth and offer a degree of dedication, honesty and integrity

•Important to remember in mind that this will often be an exclusive relationship, meaning it may very well be the only business your brand will be able to partner with in the category.

•Once a relationship is formed with a business in a specific industry, the odds of forming more in that same industry are very slim, so it is important to do it right the first time.

4. Joint Ventures/Strategic Alliances

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Building a Mutually Beneficial Alliance

•One of the biggest challenges is ensuring that partnership benefits both businesses

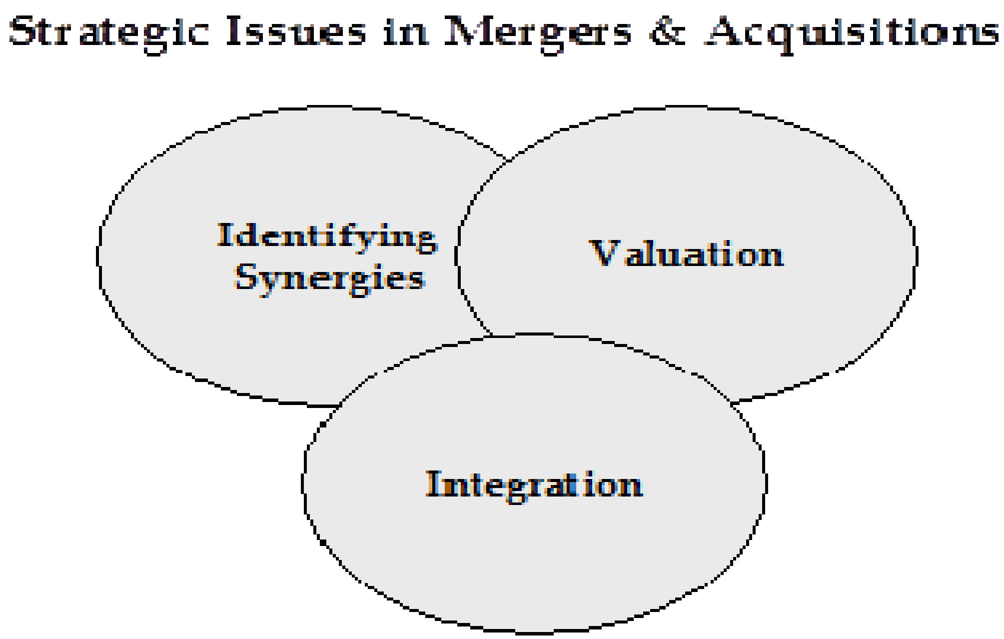
•With human nature being motivated by self-interest, often difficult to enter into a business relationship with the goal to benefit the other party just as much as it will benefit your brand

Upholding Trust and Honesty

•Without a certain degree of trust and honesty, a partnership has no foundation to build on. Important for both parties to set their expectations clearly and concisely before partnership is solidified.

5. Finding the right Merger/Acquisition target

Strategic and Operational Fit



5. Finding the right Merger/Acquisition target

<u>Cultural fit</u>

•Often significant cultural differences exist between the pre-merger entities. Managing these differences is the strategic challenge during integration.

•Consider the following examples:

- The merger of UK-based Beecham and the US based SmithKline involved not only two national cultures but also two business cultures - one very scientific and academic and the other more commercially oriented.
- The American pharmaceutical company, Upjohn's centralised and aggressive culture clashed with Swedish major Pharmacia's decentralised laid back management style.

5. Finding the right Merger/Acquisition target

Identifying synergies

•Aim of an acquisition is to make the integrated entity more valuable than the sum of the values of the pre-integration entities.

•Synergies can add value only if the integrated entity registers a performance that is better than already reflected in the value of the pre-integration entities.

•Much of the risk in an M&A deal arises from the acquiring company's inability to identify and quantify synergies accurately.

•Often, the synergies which are highlighted, do not materialise, while those which may have been completely overlooked become very important.

•Usually, it is years after the acquisition that it becomes clear whether the price paid for the acquisition was the right one or not.

5. Finding the right Merger/Acquisition target

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Reasons why mergers or acquisitions fail

•In excess of 50% of acquisitions fail to deliver expected value

•On average the share price of acquisitions goes down by between 1 and 3%

•On average acquirers returns are 5% lower than peers for at least 5 years after acquisition

•Tendency to lay too much stress on the strategic, unquantifiable benefits of the deal results in over-valuation of the acquired company

•Use of wrong integration strategies – realised synergies turn out to be well short of the projected ones

6. Executing Mergers/Acquisitions – Agreement to Integration

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Commencement of Task
Week 0 - 1

- Initial Acceptance of Assignment
- Terms of Engagement
- Introduction of BTRG Team
- Initial meeting with Owner of Business

Pre Sale Considerations
Week 2 - 4

- Asset Identification including lease interests, contracts etc.
- Preparation of detailed maintainable earnings model
- Detailed investigation of past profit / losses and reconciliation to maintainable earnings
- SWOT analysis
- Establish a credible case for the add back of expenses
- Preparation of initial valuation
- Market Research to establish interested parties
- Consideration of pre sale planning issues, format of sale, asset or share sale, tender process etc

Preparation for Sale
Week 4-5

- Preparation of blind profile/teaser document
- Identification of potential purchasers using market knowledge/research using BTRG and Company contact base
- Circulation of blind profile to pre-agreed distribution list
- Further meetings with Company to discuss sales parameters
- Collation of feedback and responses to initial circularisation

Engagement with Potential Purchasers
Week 6 - 8

- Initial Engagement with Potential Purchasers and signing of Non Disclosure Agreements
- Preparation and circulation of Information Memorandum to selected shortlist of potential purchasers
- Agreement (with Company and legal team) re initial Heads of Terms and outline offer
- Provision of financial and other information to potential purchasers to facilitate due diligence process
- Further Meetings and renegotiations with Purchasers post due diligence process if necessary

Acceptance of Tender
Week 8 - 12

- Receipt and Acceptance of Final Offers
- Preparation of final Heads of Agreement with legal team
- Finalisation of Terms of Sale
- Final meetings with Company

Finalisation of Agreement
Week 12 -14

- Liaise with Company and legal team to consider structure, timing and conditionality of consideration
- Liaise with Legal Team in relation to preparation of Purchase Agreement
- Discussions with Company and agreement on disclosure letter
- Finalisation of Agreement

6. Executing Mergers/Acquisitions – Agreement to Integration

Due diligence process

- The purpose of due diligence is to confirm the information which the bidder has received from the vendor on which it has based its bid
- Before embarking on due diligence, it is important to reflect on its purpose and possible outcomes
- With the caveat emptor ("buyer beware") principle applying, it is important that buyers uncover, insofar as it is possible, problems that may impact on the value of the business being acquired.

6. Executing Mergers/Acquisitions – Agreement to Integration

At a conceptual level, due diligence work can produce one of three outcomes:

1. No problems are discovered – information provided by the vendor is confirmed
2. Some problems are discovered but can be satisfactorily remedied in the legal contract negotiations whether by way of indemnity, warranty or purchase price adjustment.
3. A problem so large is discovered that it threatens the entire transaction ("a deal breaker").

6. Executing Mergers/Acquisitions – Agreement to Integration

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<u>Identify Key Risks and Mitigate Through Planning</u>

- Identification and prioritisation of interests – successful negotiating requires identification and prioritising interests that can trade off items of lesser priority in order to win concessions on items of greater priority
- Courtesy and decorum – it is always possible that the current negotiations may fail but, as long as they continue, it is the intended outcome of discussions that a complex transaction is concluded with the other side
- Successful completion of that deal will be better facilitated by civility than aggressive resentment – even if current discussions fail, trading or deal opportunities may arise in the future with the same counterparty

6. Executing Mergers/Acquisitions – Agreement to Integration

- Key challenges facing post-acquisition / merger integration:
  - Organising the integration of the target into the corporate practices of the acquirer causing the minimum disturbance and loss of human capital.
  - This will normally be easier the larger the acquirer is relative to the target, the more successful the acquirer relative to target and the less formalistic the acquirer's procedures.
  - Organising the finances of the target to realise planned synergy savings – easier the more realistic and more detailed the original synergy savings plans.

6. Executing Mergers/Acquisitions – Agreement to Integration

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Financial plan and funding

- Growing your business is not cheap –map out cost versus benefit analysis to guide you in the right direction.
- The key steps will be as follows:
  - Project operating results incorporating the target company including any synergy savings expected
  - Remodel the financing of the company to incorporate the financing of the acquisition of target company – to ensure that resulting debt levels correspond with what banks are willing to finance in terms of operating profit multiples and repayment schedules

6. Executing Mergers/Acquisitions – Agreement to Integration

Financial plan and funding

- Check that the financial results for the acquirer – in terms of anticipated value increase, return on capital employed and earning per share increase – are acceptable.
- In the final analysis, the following must be considered:

i. the price paid for the target company;

ii. the realism of the operating projections; and

iii. the returns which can be subsequently earned by the acquirer.

6. Executing Mergers/Acquisitions – Agreement to Integration

- There is a danger, in the pressure to "do the deal", that too high a price may be bid for Target.
- In order to "make the deal work" and still show satisfactory returns for the acquirer, overly optimistic operating results may be projected so as to justify the elevated price.
- In order to guard against this danger, it is important to prudently scrutinise both anticipated synergy savings and the resulting ROCE which operations are projected to generate.
- If the average ROCE projected over the planning horizon is one that has only been infrequently achieved in the past, caution is advised.

7. Case Study

8. Tax Planning Issues for growing SMEs - Overview

Donal Leahy – Director

- Issues to consider pre-merger/acquisition
- Preparing for international trade – minimising foreign tax liability
- Use of holding company regime
- Managing intellectual property tax efficiently
- Tax efficient financing

8.1. Issues to Consider Pre Merger / Acquisition

Ideal

•Perfect books & records and systems – extra capacity

•Taxes fully up to date

•All available reliefs catered for

•Separate components of business hived off in a timely way

•Future proofed structures, plans and systems in place for next steps

8.1. Issues to Consider Pre Merger / Acquisition

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<u>Reality</u>

•Cash / time poor – books & records and systems are sufficient, but no more

•Little / no profits – corporation tax not a concern, future liabilities not planned for

8.1. Issues to Consider Pre Merger / Acquisition

Lets Meet in the Middle

Two suggestions – think like a big company from day one

•Due diligence – Company's compliance history will be interrogated. Put formal procedures in place now. Invest now to get a better price later. Timely filing of records

•Retrospective tax planning is harder – do some now. Hive off

8.1. Issues to Consider Pre Merger / Acquisition

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Due Diligence – things to get right

•Tax position of Company will be reviewed under all heads – CT, CGT, VAT, Payroll, SD, CAT

•Purchaser wants to be reassured of financial position of Company

•Consult your tax advisor – can mission an in-depth review of all taxes

•Ensure that all tax liabilities have been accounted for and all claims for relief can be relied upon under intensive review

•Payroll taxes – has PAYE, PRSI & USC been accounted for on all wages & salaries, BIK, bonuses etc.?

•Any concerns over tax of sub-contractors?

8.1. Issues to Consider Pre Merger / Acquisition

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- Corporation Tax – have all claims for loss relief, R&D tax credits been accurately made with supporting documentation?
- VAT – Accounted for accurately on all sales and claims for input credits are correct. E.g. no VAT reclaimed on petrol?
- Has VAT on intra-group transactions been accurately recorded?
- Has VAT on acquisitions of premises been correctly accounted for?

8.1. Issues to Consider Pre Merger / Acquisition

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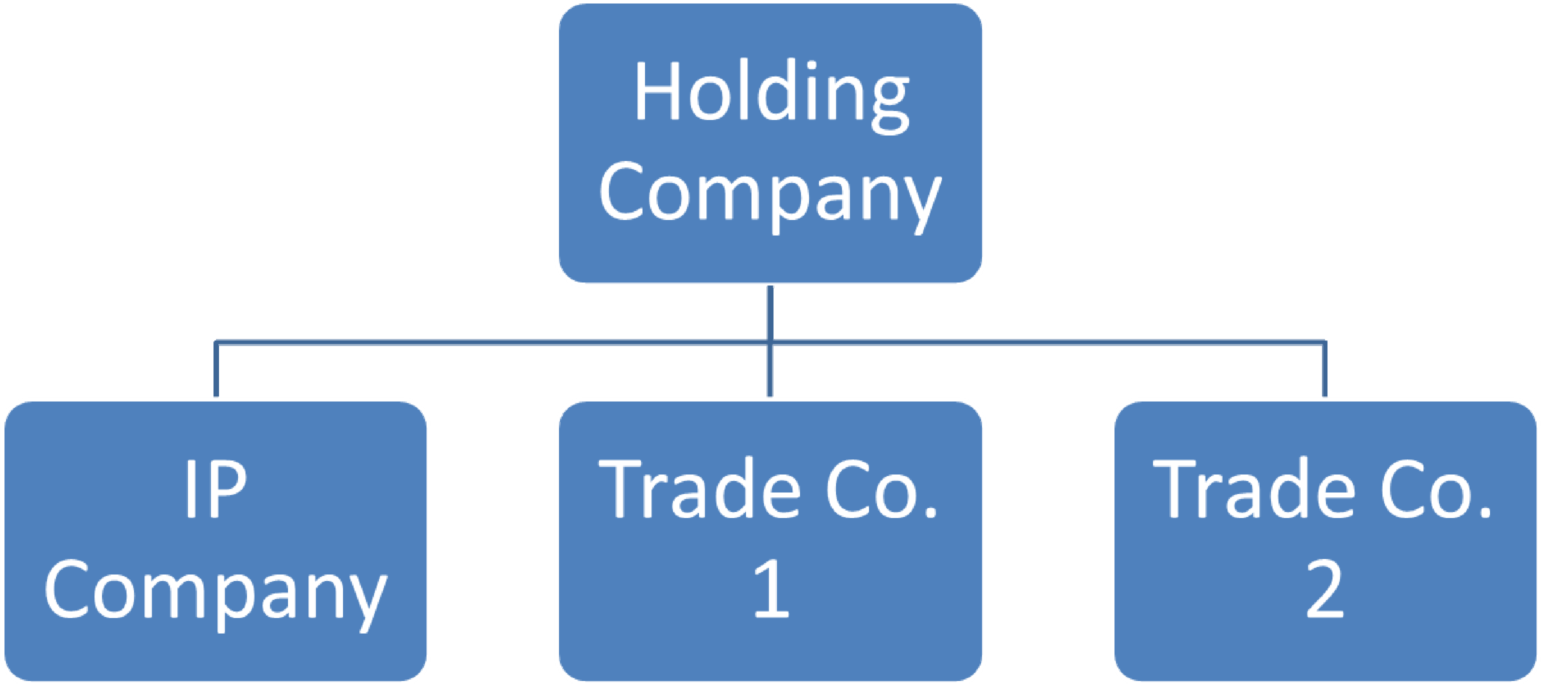
Future Proof Structure



8.2. Preparing for International Trade

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1. Transfer Pricing
2. Taxing the Cloud
3. Minimising Non-Irish Tax Footprint
4. Other Taxes

8.2. Preparing for International Trade – Transfer Pricing

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- Came into effect in Ireland in 2010
- Looks at transactions between connect parties to ensure transaction is subject to what would be arm's length pricing
- Rules apply to both cross border and domestic transactions
- Small & medium size businesses are outside scope of legislation
    - Employs < 250 +
    - Turnover < €50m; or
    - Assets < €43m

8.2. Preparing for International Trade – Taxing the Cloud

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- Take precautions to prevent tax issues / problems accumulating
- Revenue authorities are not yet tooled up for such trade
- Cross border environment & new application of rules = problems
- Possible CT issues – permanent establishment / taxable nexus, CFC rules, transfer pricing rules & withholding tax rules
- Consideration needs to be given to issues including is a server a PE? Analyse where in the chain value is added
- Export controls will be important for the export of services
- VAT issues need consideration – where is the place of supply
- Place of supply ~ place of taxation

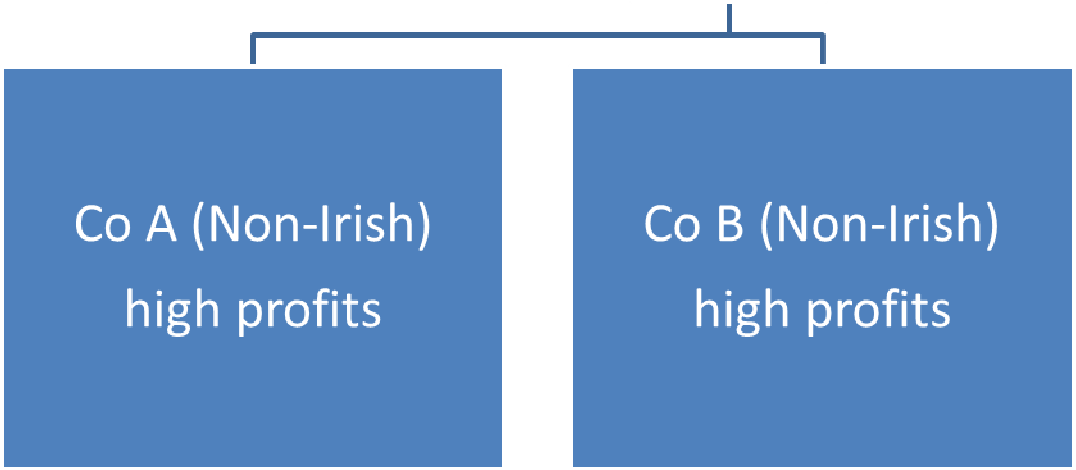
8.2. Preparing for International Trade – Taxing the Cloud

- Conclusion – this is an emerging area of tax
- Commercial structure can result in significant tax consequences – positive and negative

8.2. Preparing for International Trade – Minimising Non-Irish Tax Footprint

- PE (Permanent Establishment) – A fixed place of business through which the business of an enterprise is wholly or partially carried out
- No PE – Strategies to achieve this
- If a PE Exists – Strategies / Typical Structure

8.2. Preparing for International Trade – Minimising Non-Irish Tax Footprint



8.2. Preparing for International Trade – Minimising Non-Irish Tax Footprint

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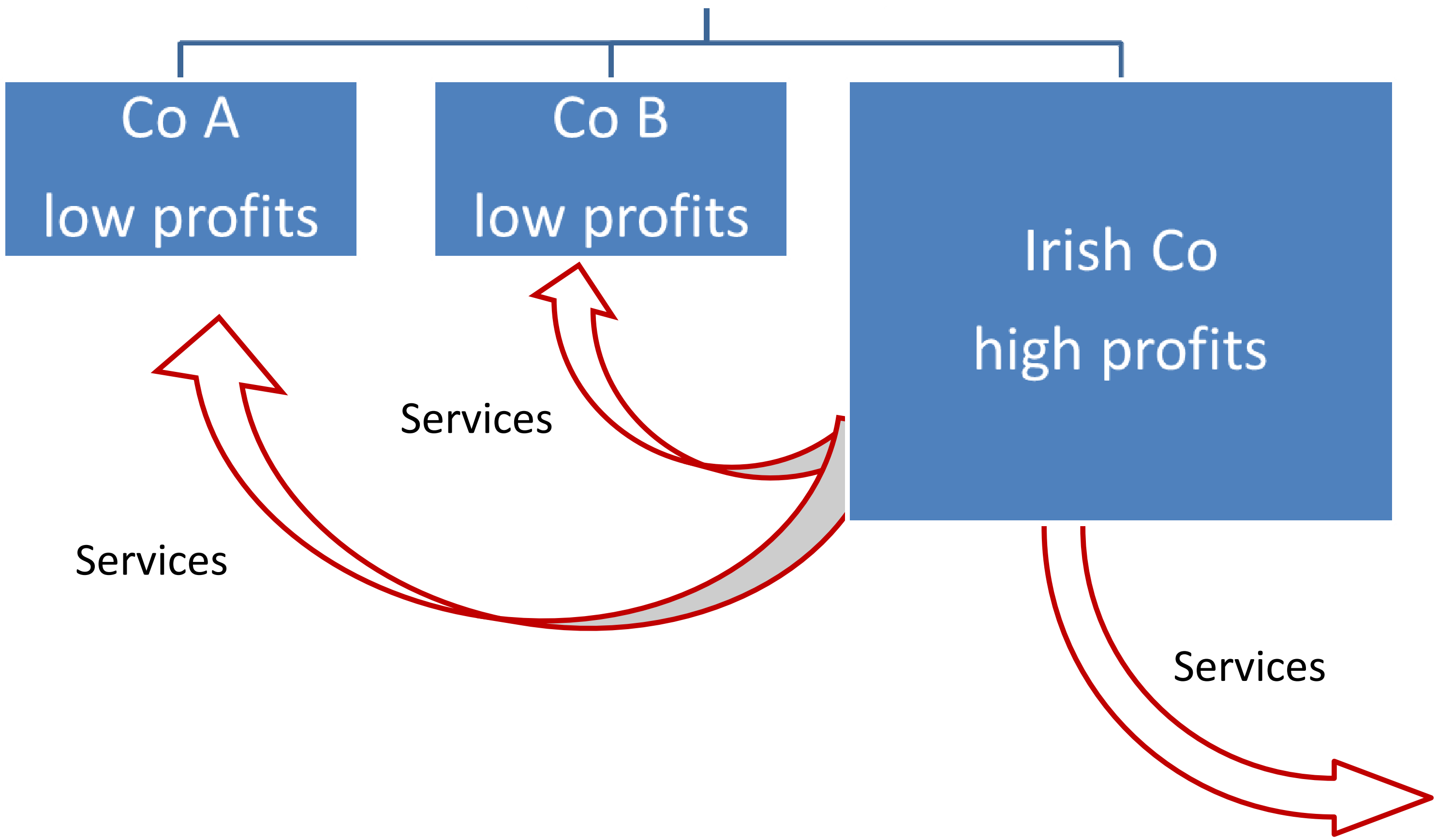

8.2. Preparing for International Trade – Minimising Non-Irish Tax Footprint

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- Leverage off Ireland's mature financial services sector to place high value non core functions in Ireland, such as:

Functions	High Value
Cash Pooling/ Treasury/ Intra group lending	High level expertise in Ireland
Factoring	Non recourse to Irish co – risk in Ireland
Reinsurance/ Captive Insurance	Maximise risk in Ireland
IP Co	Accepted high value
Internal leasing of equipment	Exposure to third parties for non payment
Vendor financing and customers	Risk of default in Ireland

8.2. Preparing for International Trade – Other Taxes

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- VAT / Sales Taxes
- Customs
- PAYE

8.3. Use of Holding Company Regime

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- Tax free disposal of shares in qualifying subsidiaries
  - Subsidiary must be trading
  - Minimum 5% holding
  - Must hold shares for 12 months
- Tax credits available for foreign dividends repatriated to Ireland
- No controlled foreign corporation (“CFC”) legislation or thin capitalisation rules
- Relatively benign transfer pricing regime
- Interest free loans permitted
  - Widely used as financing mechanisms

8.3. Use of Holding Company Regime

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- Although foreign dividend income is technically liable to tax
  - Usually possible to avoid this tax by using foreign credits
- Manage or avoid withholding taxes through:
  - Foreign tax credit pooling
  - The EU Parent–Subsidiary Directive
  - Double Taxation Agreements
- 2012 EU case – rethink of rules
  - Now credit given for overseas tax at nominal rate (as opposed to effective rate)
  - Moves the Irish system even closer to a zero tax position on dividends

8.4. Managing IP Tax Efficiently

1. Research & Development (R&D)
2. Intellectual Property (IP)

8.4. Managing IP Tax Efficiently – R & D

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- Legislation aims to encourage foreign & indigenous companies to undertake new and/or additional R&D activity in Ireland
- Coupled with the corporation tax regime it makes Ireland one of the prime locations in the world in which to undertake R&D activity

- Who can claim the relief?
  - Available to all companies who undertake R&D activities within the EU
  - For an Irish tax resident, the expenditure must not qualify for a tax deduction in another territory

8.4. Managing IP Tax Efficiently – R & D

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- 25% tax credit on qualifying incremental R&D spend
  - over the amount spent in the base year which is set at 2003
- First €200,000 of expenditure can be claimed even if
  - Below 2003 base amount
  - First €100,000 of expenditure can be outsourced even if outsourced

- In addition to the accounts deduction at rate of corporation tax (12.5% + 25% = 37.5%)

8.4. Managing IP Tax Efficiently – R & D

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- Tax credit can be used to:
  - offset against company's current or prior year corporation tax liability or;
  - carried forward against future tax liabilities or;
  - used to trigger a payroll tax refund, payable in three parts
- In some cases company can surrender R&D credits to key R&D employees

8.4. Managing IP Tax Efficiently – R & D

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- Example – In the accounting period ended 31/12/2012, ABC Ltd incurred €400,000 qualifying expenditure on R&D. The company commenced to trade in 2007 - therefore expenditure in the base year of 2003 is nil.

Tax Relief is calculated as follows:

CT Deduction	€400,000 x 12.5%	€50,000
R&D Tax Credit	€400,000 x 25%	€100,000
Total Tax Relief		€150,000

Net Cost of R&D Spend €400,000 - €150,000 = €250,000

8.4. Managing IP Tax Efficiently – R & D

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<u>Examples of Qualifying Activities (Rocket Science not Required)</u>

•Developing and/or improving a new or existing products

•Improvements to plant efficiency i.e. energy efficiency, waste reduction, yield improvements, etc

•Automation of manual processes/systems

•Plant and/or product trials, including pilot facilities

•Testing of new or modified raw materials

•Development of solutions to reduce product returns/technical failures

•Costs of R&D buildings - can avail of the 25% credit

8.4. Managing IP Tax Efficiently – IP Capital Allowances

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- Tax relief available for expenditure on Intellectual Property
- Relief is capital allowances against trading income
- Irish IP Relief + Corp Tax + R&D Relief + legislation = <u>prime location to exploit IP</u>

<u>How it works:</u>

- The tax deduction:
  - matches the annual accounts based depreciation/amortisation of the asset or;
  - an election can be made to claim the allowances over 15 years
- Available for offset against trading income generated from the exploitation of IP assets

8.4. Managing IP Tax Efficiently – IP Capital Allowances

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- What Intangible Assets are Covered?
- The scheme applies to intangible assets which:
  - are recognised as intangible assets under generally accepted accounting practice; and
  - which are listed as specified intangible assets in the legislation

8.4. Managing IP Tax Efficienctly – IP Capital Allowances

- What is a Specified Asset?
- Legislation details a broad list of specified assets and includes the acquisition of or the license to use:
  - Patents and registered trademarks
  - Trademarks and brand names
  - Know-how
  - Domain names, copyrights, service marks and publishing titles
  - Authorisation to sell medicines or a product of any design, formula, process or invention
  - Goodwill, to the extent that it relates to the aforementioned assets

8.4. Managing IP Tax Efficiently – IP Capital Allowances

IP tax relief will not be clawed back on the disposal of an IP asset if:

- the disposal takes place in 5 years following date asset was first acquired for use in the trade and;
- provided the asset is not disposed to a connected company

Irish legislation provides an exemption from stamp duty on the purchase of most IP assets

8.4. Managing IP Tax Efficiency – IP Capital Allowances

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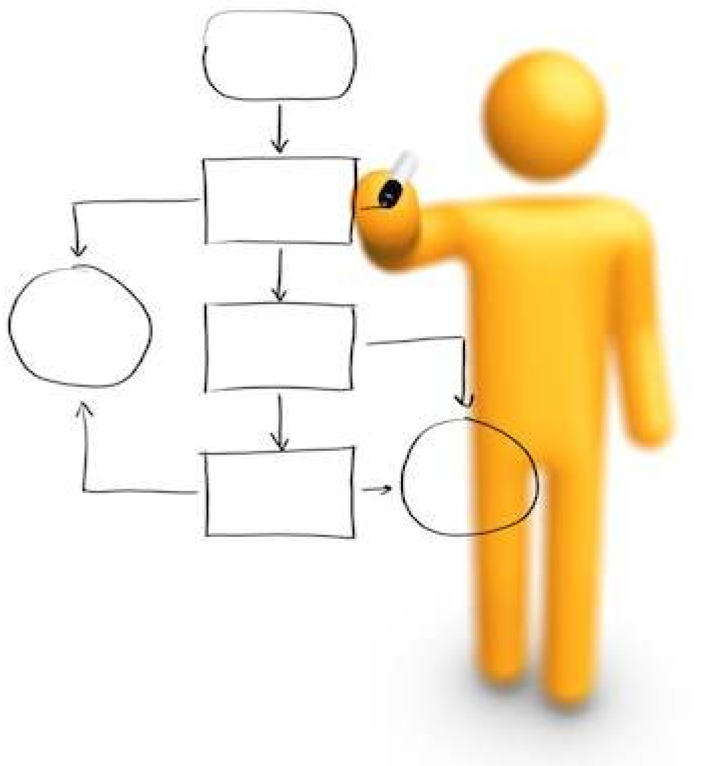
Typical Example - Irish company acquires IP from a Group Company for €10m

•Accounting w/o of IP over 4 years (€2.5m pa)

•Normal trading profits of €3m per annum

•Taxable Income for next 4 years reduced to €0.5m (@ 12.5% = €62,500)



8.5. Tax Efficient Financing

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1. Employment & Investment Incentive (EII)
2. Seed Capital Scheme (SCS)
3. Venture Capital – Carried Interest

8.5. Tax Efficient Financing – EII

- Relief for Investment in corporate trades – Employment & Investment Incentive (EII)
- Replaces relief for investment in the Business Expansion Scheme (BES)
- The scheme allows an individual to obtain income tax relief on investments up to a max of €150,000 p.a
- Relief is initially available to an individual at 30% - a further 11% relief will be available once conditions met – e.g. company activity
- Unrelieved credit can be carried forward

8.5. Tax Efficient Financing – Seed Capital Scheme (SCS)

- SCS provides for tax relief for an individual when that individual sets up and takes employment in a new qualifying business
- Receive a refund of all income tax paid over the prior 6 years if investment is big enough
- Certain conditions apply surrounding the investment, the person and the Company

8.5. Tax Efficient Financing – Venture Capital – Carried Interest

- Tax regime for the return (known as carried interest) received by venture capital managers for managing investments in certain venture capital funds
- Treats carried interest which is received by a partnership or a company as a chargeable gain
- Charged to CGT @ 15% if received by individual or partnership and 12.5% if received by company

Contact

BAKER TILLY
RYAN GLENNON

Baker Tilly Ryan Glennon

Tel: +353 1 496 5388
Mobile: +353 86 6011 332

Brian Hyland – bhyland@bakertillyrg.ie

Donal Leahy – dleahy@bakertillyrg.ie

Aine Farrelly – afarrelly@bakertillyrg.ie

Conor Foley – cfoley@bakertillyrg.ie