Corporate restructuring guidelines
Auditing, accounting and taxation

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AUDITING, ACCOUNTING AND TAXATION

Introduction

The following section addresses certain common issues faced by companies and their auditors in the current environment. In particular it focuses on some of the more common accounting and tax issues impacting companies and how those matters would be accounted for and disclosed in a companies audited financial statements. It also addresses how an auditor deals with those issues as part of their audit and the impact of those issues on the auditors report on a company’s financial statements. The section first addresses the application of the going concern to a company’s financial statements and the factors, many of which have become more common in the current environment that may create uncertainty on the appropriateness of the going concern basis to financial statements. Secondly it discusses a number of the more common accounting issues including their disclosure in financial statements. Finally it notes certain disclosure requirements imposed by the Companies Acts on the director’s report.

The section has focused on the use of Irish Generally Accepted Accounting Principles (“Irish GAAP”) as Irish GAAP is the predominant GAAP currently used by non listed Irish companies in the preparation of their financial statements. The Accounting Standards Board (“ASB”) recently issued a consultative document proposing that Irish and UK GAAP would be replaced by a three tiered hierarchy of GAAP based on International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The level of IFRS proposed to be applied to an entity will be dependant on its nature, with publicly accountable entities (as defined by the IASB) required to adopt full EU endorsed IFRS. It is proposed that small entities as defined by the Companies Acts would follow accounting guidance contained in the ASB’s Financial Reporting for Small and Medium Sized Entities (“FRSSE”) and all other entities would follow IFRS for small and medium sized entities as issued by the IASB in July 2009. The ASB currently expects that this significant change to the accounting landscape of Irish and UK entities will become effective for financial years no earlier than 1 January 2012. Further details on the impact of this proposed change and on the new IFRS for SME’s is available on: http://www.pwc.com/ie/ifrsforsme/
Audit Requirements and Disclosure obligations

1. Going Concern

The fundamental principle in the preparation of financial statements for any company is that the company will continue in existence as a going concern and its financial statements have been prepared on that basis. The concept of going concern is defined in International Standard on Auditing 570 “Going Concern” (“ISA 570”) as follows:

“Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations. Accordingly, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.”

Financial Reporting Standard 18 “Accounting Policies” (“FRS 18”) states that, “An entity should prepare its financial statements on a going concern basis unless:

1. “The entity is being liquidated or has ceased trading or
2. The directors either intend to liquidate the entity or to cease trading, or have no realistic alternative but to do so”.

Management are required to make an assessment of an entity’s ability to continue as a going concern. In making this assessment, management must take account of all available information for the foreseeable future. This period of consideration is to cover a period of at least 12 months from the balance sheet date of the relevant financial statements. (International Accounting Standard 1 – “Presentation of Financial Statements”)

The extent and level of consideration to be made by management is not defined but is dependant on the specific facts and circumstances of each case. For example, management of an entity with a history of profitable operations and access to sufficient financial funding may reach a conclusion that the going concern basis is appropriate without undertaking a detailed analysis to support that assessment. However, certain factors (as detailed below under Financial, Operating and Other categories) may give rise to uncertainty or cast significant doubt as to the appropriateness of the going concern basis. Para 8 of ISA 570 provides three categories of such factors:

1. Financial, factors include;
   a. A net liability or net current liability position,
   b. Fixed term borrowing approaching maturity without realistic prospects of renewal or repayment,
   c. Indicators of withdrawal of financial support by debtors and other creditors,
   d. Negative operating cash flows indicated by historical or prospective financial statements,
   e. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows,
   f. Inability to pay creditors on due dates,
   g. Inability to comply with the terms of loan agreements, and
   h. Change from credit to cash-on-delivery transactions with suppliers.
2. Operating, factors include;
   a. Loss of key management without replacement,
   b. Loss of a major market, franchise, license or principal supplier/customer, and
   c. Labour difficulties or shortages of important supplies; and
3. Other, factors include;
   a. Non-compliance with capital or other statutory requirements,
b. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that are unlikely to be satisfied, and
c. Changes in legislation or government policy expected to adversely affect the entity.

In the current economic environment many entities are experiencing some of the factors listed in ISA 570 and in such cases, management’s assessment of that entity’s ability to continue as a going concern would require preparation of a detailed analysis, which may involve consideration of forecast results, planned business developments, access to funding and consideration of likely outcomes of uncertain events, including for example, outstanding litigation, contract renewals or outcomes of refinancing.

From an auditor’s perspective, the auditor has an obligation to consider both the appropriateness of management’s use of the going concern basis and whether there are any material uncertainties about the use of going concern that require disclosure in the financial statements. The auditor should remain alert for events or conditions and related business risks which may cast significant doubt on the entity’s ability to continue as a going concern throughout the audit.

In evaluating management’s assessment of going concern, the auditor will consider the same period as management, however, typically where financial statements may not be approved for some time after their balance sheet date, the auditor will consider factors and events for a period of 12 months from the expected dating of their audit report. This may be particularly appropriate where there are a number of factors giving rise to significant doubt as to the appropriateness of the going concern basis.

Where such factors exist para 26 of ISA 570 states that the auditor should review management’s plans for future action and gather sufficient appropriate audit evidence to ascertain whether a material uncertainty exists. The audit procedures to be performed may involve considering the impact of any planned management actions, mitigating factors and seeking written representations from management on those plans. The extent of the procedures that may be performed by the auditor in such circumstances depends on the nature of the factors giving rise to significant doubt. For example for a highly leveraged entity whose future is dependant on successful refinancing or renegotiation of existing debt facilities, the auditor may read board minutes and correspondence with lending institutions, and may confirm the existence of existing facilities or review draft terms of proposed facilities to ascertain the likelihood of their renewal and consider the impact of renewal or not on management’s forecast results and cash flows for the future period.

Based on the results of the auditor’s assessment, they must determine whether:

“...in the auditor’s judgement, a material uncertainty exists related to events or conditions that alone or in aggregate, may cast significant doubt on the entity’s ability to continue as a going concern” (ISA 570, para 30)

The auditor must also consider the disclosures made by management in the financial statements in relation to the going concern assessment and whether the disclosures are appropriate. The auditor must consider whether the financial statements:

- Adequately describe the matters giving rise to any material uncertainty regarding going concern;
- Adequately describe management’s plans to deal with those events and;
- State clearly that a material uncertainty exists which may cast significant doubt on the entity’s ability to continue as a going concern and prevent it from realising its assets and discharging its liabilities in the normal course of business.
FRS 18 requires that where directors believe there is significant doubt about an entity’s ability to continue as a going concern for the foreseeable future and have considered the existence of any material uncertainties giving rise to that significant doubt, the directors must disclose the existence of those uncertainties.

Typically such disclosures are contained in Note 1 “Basis of Preparation” immediately following the primary statements. The adequacy and appropriateness of the disclosures made by management in the financial statements have a critical impact on the auditor’s report with the impact thereon illustrated in the following paragraphs.

If management conclude that the going concern assumption is not appropriate, the financial statements need to be prepared on an alternative authoritative basis (break up basis of accounting).

The auditor will consider all information available to him to the point of his signing of the audit report. In this regard it is important to be aware that in accordance with Financial Reporting Standard 21 “Events after the Balance Sheet date” (“FRS 21”) (para 15) if events subsequent to the balance sheet date indicate that the going concern basis is no longer appropriate, then FRS 21 requires a fundamental change in the basis of accounting applied to those financial statements, in effect the use of the break up basis of accounting.

Following the conclusion of the auditor’s assessment, he must consider the implications for the audit report. The audit report can be impacted in one of the following ways depending on the adequacy of disclosures in the financial statements or whether the auditor believes that the use of the going concern basis is not appropriate.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Auditor conclusion</th>
<th>Impact on Audit Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Going Concern basis applied and appropriate. No material uncertainty existing</td>
<td>No impact – unqualified audit opinion, no modification to audit report.</td>
</tr>
<tr>
<td>2</td>
<td>Material Uncertainty regarding appropriateness of going concern exists.</td>
<td></td>
</tr>
<tr>
<td>2 (a)</td>
<td>Adequate disclosure made in the financial statements.</td>
<td>Emphasis of matter paragraph added. Audit opinion unqualified.</td>
</tr>
<tr>
<td>2 (b)</td>
<td>Adequate disclosure not made in financial statements</td>
<td>Adverse or qualified audit opinion.</td>
</tr>
<tr>
<td>3</td>
<td>Going Concern basis applied but not appropriate</td>
<td>Adverse audit opinion.</td>
</tr>
</tbody>
</table>

2. Impairment of fixed assets including goodwill and intangible assets

The issue of whether fixed assets, goodwill and intangible assets are impaired is becoming increasingly prevalent as market prices continue to fall. The area remains one of considerable judgement for management and a key area of focus for auditors despite the prevailing guidance for impairment, Financial Reporting Standard 10 “Impairment of Fixed Assets including Goodwill” (FRS 11) being in existence for over 10 years.

FRS 11, defines impairment as;

“A reduction in the recoverable amount of a fixed asset or goodwill below its carrying amount.”

FRS 11 para 8, states that:
“A review for impairment of a fixed asset or goodwill should be carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset or goodwill may not be recoverable.”

Para 10 of the standard then outlines examples of events which may indicate that an asset's carrying value may be impaired (“triggering events”). These include:

- “A current period operating loss in the business in which the fixed asset or goodwill is involved or net cash outflow from the operating activities of that business, combined with either past operating losses or net cash outflows from such operating activities or an expectation of continuing operating losses or net cash outflows from such operating activities;
- A significant decline in a fixed asset's market value during the period;
- Evidence of obsolescence or physical damage to the fixed asset;
- A significant adverse change in:
  - either the business or the market in which the fixed asset or goodwill is involved, such as the entrance of a major competitor;
  - the statutory or other regulatory environment in which the business operates; and
  - any 'indicator of value' (for example turnover) used to measure the fair value of a fixed asset on acquisition.
- A commitment by management to undertake a significant reorganisation;
- A major loss of key employees; and
- A significant increase in market interest rates or other market rates of return that are likely to affect materially the fixed asset's recoverable amount.”

If indicators of impairment are present it increases the likelihood of impairment and FRS 11 requires an impairment assessment to be performed by management in such conditions. Review of the impairment assessment is the only reliable way for auditors to gain comfort over the valuation of goodwill.

Goodwill is impaired when its book value is in excess of its recoverable value. Recoverable value is defined as the lower of net realisable value (disposal proceeds less selling costs); and, the value in use (present value of any future cash flows from the assets continued use including cash flows from its ultimate disposal).

Where it is not reasonably practicable to identify cash flows arising from an individual fixed asset, value in use should be calculated at the level of income-generating units (groups of assets and liabilities, together with their associated goodwill). The carrying amount of each income-generating unit containing the fixed asset or goodwill under review should be compared with the higher of the value in use and the net realisable value of the unit.

The auditor is likely to pay particular attention to values placed on fixed assets and goodwill in the current environment and consider the results of any impairment calculations performed by management and form a view on the adequacy of the recoverable values and disclosures made in the financial statements on the impairment. In the event of any impairment being recorded, the remaining useful economic life and any residual value may require revision with the adjusted carrying value depreciated or amortised over the revised useful economic life.

FRS 11 states that an impairment loss should be recognised in the Profit and Loss account where the loss is caused by the consumption of economic benefits (for example physical damage or deterioration of an asset).

Impairment of Revalued Assets
An impairment loss on a revalued fixed asset should be recognised in the profit and loss account if it is caused by a clear consumption of economic benefits. Other impairments of revalued fixed assets due to general changes in prices, for example a general slump in the property market, should be recognised in the statement of total recognised gains and losses until the carrying amount of the asset reaches its depreciated historical cost and thereafter in the profit and loss account.

Impairment after the balance sheet date

Consideration is required as to whether the occurrence of any such indicators after the balance sheet date may be an indicator that the asset was impaired at the balance sheet date. In such a case, in accordance with FRS 21, the event would be deemed to be adjusting and the carrying value of the asset at the balance sheet date would be subject to an impairment calculation.

Disclosure

Impairment losses recognised in the profit and loss account should be included within operating profit and disclosed as an exceptional item if appropriate. Impairment losses recognised in the statement of total recognised gains and losses should be disclosed separately on the face of that statement. FRS 11 includes additional disclosures in paragraphs 68 – 73 inclusive.
Auditor/accountant issues

In the current environment, entities are likely to experience one or many of the following topical accounting issues.

1. Disposal or termination of an operation;
2. Accounting for restructuring provisions;
3. Accounting for onerous contracts;
4. Impairment of Fixed Assets including Goodwill (detailed above);
5. Impairment of Inventories;
6. Recoverability of accounts receivable, and
7. Completeness of liabilities.

Each of the above matters, excluding impairment of fixed assets including goodwill (discussed previously) will be dealt with in brief in the following paragraphs.

1. Disposal or termination of an operation

The relevant guidance is contained in Financial Reporting Standard 3 “Reporting Financial Performance” (“FRS 3”). FRS 3 focuses on the presentation of such transactions in the financial statements and sets out three criteria for the classification of the results of a disposed or terminated operation as “discontinued operations”. Operations that are sold or terminated and which meet all three criteria are classified as discontinued in the Profit and Loss account. The standard requires particular disclosures in the Profit and Loss account for continuing, discontinued or acquired operations.

The minimum disclosure required on the face of the Profit and Loss account is an analysis of turnover and operating profit between continuing, discontinued and acquisitions. Further analysis of the remaining profit and loss statutory format items between these categories can be shown as a note to the financial statements, if not shown on the face of the Profit and Loss account.

FRS 3 provides specific guidance as to the items that can appear as discontinued operations. In particular para 17 states that

“Only income and costs directly related to discontinued operations should appear under the heading of discontinued operations. Reorganisation or restructuring of continuing operations resulting from a sale or termination should be treated as a part of continuing operations.”

FRS 3 also states that any profit or loss in respect of the sale or termination of an operation is an exceptional item, should be charged or credited in calculating the profit or loss on ordinary activities and is categorised within discontinued operations. Any such profit or loss must be shown separately on the face of the Profit or Loss account, unless immaterial, where disclosure by way of a note to the Profit and Loss account is appropriate.

2. Accounting for restructuring provisions;

Financial Reporting Standard 12 “Provisions, contingent liabilities and contingent assets” (“FRS 12”) defines a provision as a liability of uncertain timing or amount. A provision should be recognised when an entity has a present obligation (legal or constructive) as a result of a past event; it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation (“basic recognition criteria”).

FRS 12 provides an indicative list of items qualifying as restructuring:

1. Sale or termination of a line of business;
2. The closure of business locations in a country or region or the relocation of business activities from one country or region to another;
3. Changes in management structure, for example, eliminating a layer of management; and
4. Fundamental reorganisations that have a material effect on the nature and focus of the entity’s operations.

To constitute a constructive obligation for a restructuring provision, the entity must have:

- “A detailed formal plan identifying (at least)
  - The business or part of a business concerned;
  - The principal locations affected;
  - The location, function, and approximate number of employees who will be compensated for terminating their services;
  - The expenditures that will be undertaken; and
  - When the plan will be implemented.

- Raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it (para 77)

FRS 12 provides further guidance on what constitutes a constructive obligation. For example if an entity has commenced the actions in a restructuring plan, such as the disposal of assets, plant closures or has made a public announcement of the plan, provided the announcement contains sufficient detail that those affected by the plan have a valid expectation that the plan will be carried out. Furthermore, for an announcement of a restructuring to create a constructive obligation, the plan must be implemented as soon as possible, with a timeframe to completion that makes significant changes to the plan unlikely.

It is also important to note that board approval of a restructuring plan prior to the balance sheet date, does not by itself give rise to a constructive obligation warranting recognition of a restructuring provision. Board approval of a plan prior to the balance sheet date must be accompanied by either of the following in order to recognise a restructuring provision:

- Implementation of the plan; or
- Announcement of the plan subject to the above guidelines.

A restructuring provision can only include the direct costs of a restructuring. FRS 12 (para 85) defines these costs as:

- Those costs necessarily entailed by the restructuring; and
- Not associated with the ongoing activities of the company.

Restructuring provisions and costs exclude future costs or losses of the company. Examples of the costs excluded from restructuring include:

- Costs of retraining or relocating continuing staff; and
- Marketing and investment in new systems or networks.

Restructuring costs or provisions cannot be reduced by the expected proceeds from any asset disposals even where the disposal of assets forms part of any restructuring provision.

In respect of any restructuring provision the entity must make the following disclosures:

1. Narrative description of the basis for the provision, the nature of the obligation and the expected timing of outflows together with any assumptions underlying the provision; and
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2. A reconciliation (typically in tabular format) of the opening and closing balance of the provision, showing additional charges, amounts charged against the provision, amounts reversed and the impact of any change to the discount rate used (for provisions expected to span a period of time).

3. Accounting for Onerous Contracts

An onerous contract is defined by FRS 12 as “… a contract in which the unavoidable costs of meeting the obligations under it exceed the economic benefits expected to be received under it.”

Unavoidable costs are the lower of any exit costs including penalties from a contract and the costs of fulfilling the contract. An example of an onerous contract may be the lease costs on a vacant facility or the costs to exit from the remaining period of a lease.

Provided the “basic recognition criteria” (defined previously) contained in FRS 12 are met, an entity can recognise a provision for an onerous contract. The disclosure obligations for any such provision are similar to those set out previously in respect of restructuring provisions.

4. Impairment of Fixed Assets including Goodwill

Comments in relation to this section are provided as a part of Section 3(d) Audit Requirements and (e) Disclosure Obligations.

5. Impairment of inventories

Statement of Standard Accounting Practice 9 “Stocks and Long term Contracts” states that inventories should be valued at the lower of cost and net realisable value. Net realisable value is the actual or estimated proceeds from the sale of items of stock (net of trade discounts, but before settlement discounts) less all further costs to completion and less all costs to be incurred in marketing, selling and distributing the items in question.

The principal situations in which net realisable value is likely to be less than cost include:

1. An increase in costs or a fall in selling prices,
2. Physical deterioration of stocks and/or obsolescence of products,
3. A company’s marketing decision to manufacture and sell products at a loss,
4. Errors in production or purchasing, and
5. Loss of a key customer.

6. Recoverability of accounts receivable

In stagnant/declining economic conditions it is more likely that companies will find it more difficult to recover monies invested in debtors that would have been the case under buoyant economic conditions.

As a result, accounting for potentially impaired/irrecoverable debtors is a key consideration. Assessing potential bad debts requires a significant amount of judgement and will require robust auditor/management discussion.

Auditors are likely to pay close attention to the adequacy of provisioning for doubtful receivables, including reviewing the aged receivables listing and movements and any ageing deterioration therein, management discussion, debtors previous payment history and the entity’s recent trading history with its debtors and all available information as to their ability to repay amounts due to the entity.

Impairment of inventories and accounts receivable after the balance sheet date
As with the impairment of fixed assets including goodwill, the occurrence of post balance sheet events giving rise to additional information about the net realisable value of inventories or the collectability of receivables may be a cause of rather than a consequence of the post balance sheet events and may be an indicator of impairment at the balance sheet date. This is an area of some judgement and requires careful consideration of the facts and circumstances of the post balance sheet event and an understanding of the events giving rise to that event.

7. Completeness of liabilities

Liabilities, including provisions, tend to rise in times of economic downturn. Management and auditors need to ensure that there are no liabilities that exist at the balance sheet date which have not been recorded.

Companies Acts requirements

Some of the more significant Companies Acts requirements are discussed briefly below:

Directors’ report

- Section 158 of the 1963 Act requires that a directors’ report on the state of affairs of the company/group shall be attached to every balance sheet laid before the AGM.
- Section 13 of the 1986 Act notes that the directors’ report shall contain:
  - A fair review of the development and performance of the company’s business and of its position together with a description of the principal risks and uncertainties that they face. This review should be balanced and comprehensive.
  - Particulars of important events affecting the company which have occurred since the end of the year.
  - An indication of the likely future developments in the business of the company.

Covenants and banking arrangements

Section 67 of the Schedule to the 1986 Act notes the following:

"For the purposes of this Schedule, a loan shall be treated as falling due for payment, and an instalment of a loan shall be treated as falling due for payment, on the earliest date on which the lender could require repayment or (as the case may be) payment, if he exercised all options and rights available to him."

Therefore, if an entity has breached covenants at the year-end or if a banking facility is due for renewal within 12 months of the year-end the bank borrowings should be classified as current at the year-end. Rectification of breached covenants post year-end does not impact the year end position, and is therefore a non-adjusting post balance sheet event.
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Taxation

The completion of corporate recovery and restructuring transactions can give rise to a number of taxation consequences across a number of tax heads. In the absence of careful planning material tax liabilities can arise.

1. Re-organisation of Group Structures

The transfer of assets or shares of companies within a group can give rise to a number of taxation consequences. Although a number of reliefs are available which can potentially allow for a restructuring of a group to be completed without any charge to tax it is important to consider whether the proposed transactions fall within the specific conditions of each relief. In particular it is important to consider the post transaction holding periods which could give rise to a claw-back of the reliefs.

Transfer of Business Assets

- The transfer of business assets which constitute a trade are likely to give rise to a number of corporate tax consequences such as the end of an accounting period for corporate tax compliance, the disposal of the assets for capital allowances and the potential curtailment of losses carried forward. It will be necessary to consider the corporation tax compliance consequences and whether the transfer could qualify for capital allowances and transfer of loss reliefs.

- A charge to capital gains tax will arise where certain assets described as chargeable assets are transferred. Chargeable assets include land & buildings, plant & equipment, intangible assets and certain debts.

Where the transfer occurs between 75% related Irish companies, which have a common EU resident parent, a claim for capital gains tax relief may be available. It will be important to consider the potential claw-back of this relief within the ten year holding period once the relief is applied.

- It will be necessary to consider the stamp duty consequences of the transfer of each class of assets which will be transferred. Stamp duty at a rate of up to 6% is payable on the transfer of certain business assets.

It may be possible to transfer certain categories of assets without a charge to stamp duty if the completion of the transaction is structured correctly. It will however be necessary to take great care in the preparation of the legal documents and the circumstances in which the assets are transferred. Some of the classes of asset such as intellectual property may qualify for the exemption.

Where it is not possible to transfer assets without a charge to stamp duty it may be possible to make a claim for associated companies stamp duty relief. This relief allows 90% related companies to avoid a charge to stamp duty on the transfer of assets between them. It will be important to consider the conditions of the relief including the requirement to make a formal application to Revenue and the two year period in which the 90% group relationship will need to be maintained.

- Where the consideration for the transfer of business assets is shares in a company it may be possible to claim share for undertaking relief for both stamp duty and capital gains tax. These reliefs will allow for the transfer of the assets without a charge to capital gains tax or stamp duty. It will however be necessary to consider the conditions of these reliefs including the
requirement that the assets transferred constitute an undertaking (a business which can be operated on an independent basis).

- The transfer of business assets may give rise to an obligation to charge VAT. It will be necessary to consider if a claim for transfer of business relief could potentially mitigate this obligation.

- The transfer of employees could give rise to a number of administrative difficulties such as the issue of P45s for all employees. The provision of appropriate notification to Revenue could mitigate these difficulties.

It may also be necessary to consider the effect that the transfers may have on employee remuneration structures such as share options or other share based incentives.

Transfer of Shares of Group Companies

- A charge to capital gains tax may arise on the transfer of the share capital of an Irish company within a group. This may arise where the parent company is resident for corporate tax purposes in Ireland or where the shares of the company being transferred derive a greater part of their value from Irish land and buildings.

It may be possible for a holding company to claim an exemption from capital gains tax on the disposal of its subsidiary under the substantial shareholding relief. The conditions of the relief include a 5% shareholding requirement for at least a one year period and a requirement that the subsidiary or the group as a whole mainly carries on trading activities.

Where the transfer occurred between 75% related companies, which have a common EU resident parent, a claim for capital gains tax relief may be available. It will be important to consider the potential claw-back of this relief within the ten year holding period once the relief is applied in the case of both the current transaction and in the case of any restructuring transactions previously undertaken.

- The transfer of the share capital of an Irish registered company will be within the charge to stamp duty. Certain transfers of non-Irish registered shares can also be within the charge to Irish stamp duty so it is important to consider this issue.

Where the transfer occurs between 90% related companies a claim for associated companies stamp duty relief may be possible. This relief allows 90% related companies to avoid a charge to stamp duty on the transfer of assets. It will be important to consider the conditions of the relief including the requirement to make a formal application to Revenue and the two year period in which the 90% group relationship will need to be maintained.

It is also important to consider transfer tax issues in each jurisdiction where a company may have a subsidiary. A number of countries levy a transfer tax on transfers of ownership at holding company level.

- Where the consideration for the transfer of shares is shares in another company it may be possible to claim share for share relief or by concession share for undertaking relief for both stamp duty and capital gains tax. These reliefs will allow for the transfer of the shares without a charge to capital gains tax or stamp duty. It will however be necessary to consider the conditions of these reliefs including the requirement that the assets held by the company being transferred constitute an undertaking (a business which can be operated on an independent basis).
Transaction Costs on Group Re-organisation Costs

- The deductibility of transaction costs for VAT and corporate tax purposes should be considered when undertaking a group restructuring. Restrictions may apply where there are cessations of activities and transfers of shares.

Financing Structures

- It is also important to consider the impact that the group restructuring transactions may have on group financing transactions. If incorrectly planned the group may suffer of a loss of the corporate tax deduction on its interest charges.

Revenue Pre-clearance

- If a number of complex restructuring transactions are proposed it may be prudent to seek pre-approval from Revenue in order to confirm that the transactions will qualify for all of the reliefs which will be relied upon.

- In addition it may also be necessary to apply for a capital gains tax clearance certificate if certain chargeable assets, such as Irish land and buildings or goodwill of an Irish trade, are being transferred.

2. Re-organisation of activities within a company

General deductibility of restructuring costs

In general a corporate tax deduction will be available for restructuring costs for a company once.

- the expenses are incurred wholly & exclusively for the purpose of the trade of the company, and

- the expense is revenue in nature.

It will be necessary to undertake a review of the costs which will be incurred as a part of the re-organisation of a company’s trade. Some of the factors which will need to be considered include;

- The timing of any corporate tax deduction which is available will be based on the accounting treatment of the expense. Although Revenue have accepted that a deduction will be available once a provision is made under FRS12 they have in a number of specific cases challenged the accounting treatment adopted by Taxpayers.

- The restructuring may involve the write down of some of the company’s inventory and receivables. In order to obtain a tax deduction on this charge it will be necessary in most cases for the Taxpayer to be able to identify the specific assets which are being written down.

- An impairment charge may also be made on the company’s fixed assets including goodwill. Where capital allowances are not available on these assets no corporation tax deduction will be available. If the assets do qualify for capital allowances the corporate tax deduction is likely to be only available once the asset is disposed of.

- In many cases costs such as payments to discharge onerous contracts will be non-deductible. It may be necessary to consider the loss of the corporate tax deduction in the context of the discount obtained for settling the onerous obligation.
Changes in a company’s activities may result in it being deemed to create a new trade. In such a case the expenses associated with the finalisation of old activities may not be deductible.

Redundancy of Staff

The completion of a redundancy program is likely to give rise to a number of taxation consequences based on the profile of each individual company.

- It will be necessary for the company to correctly identify the proportion of the redundancy payments which are within the charge to PAYE / PRSI. A company is likely to be required to provide notification to Revenue in order to maximise the exempt amount for its employees.

- The redundancy of staff may trigger other benefits for employees. For example, the redundancy of staff may give rise to the accelerated vesting of share options. The provision of this type of benefit may give rise to the crystallisation of tax liabilities.

- The corporate tax deductibility of redundancy costs will also have to be considered in the context of the level of activity the specific company will undertake in the future. It will also be necessary to consider a claim for a rebate from the Social Insurance Fund administered by the Department of Enterprise, Trade and Employment.

3. Restructuring of activities

The completion of a re-organisation of a company’s business may lead to the cessation of some of the activities and the commencement of new and changed business. An important concept in determining the corporate tax profile of a company is considering whether a company is continuing the same ‘trade’ for corporate tax purposes. A change by a company to a new trade can have a number of different tax consequences including:

- The expiry of losses carried forward.
- A change in the company’s corporate tax compliance obligations. (i.e. the end of an accounting period.)
- A change in the company’s entitlement to capital allowances where the assets are no longer used for trading purposes.

It will be necessary to consider the likelihood of this issue affecting a company based on the individual circumstances of each company.

If a company is found to have ceased its trade it may be possible to set back the losses incurred in the year to the date of cessation against its taxable income in the three preceding years.

Receipt of Forgiveness of Debt

As a part of a restructuring of the operations and finances of a company it may be in receipt of the forgiveness of a part of its debt. This may occur where commercial creditors agree to accept a settlement of a loan for less than the full amount owed or where shareholder loans are forgiven in order to allow a company to meet banking covenants.

The receipt of the forgiveness of a loan can potentially give rise to a charge to tax as the company will be recognising the benefit of the forgiveness of some of its debts in its profit and loss account. In general the forgiveness of balances which were created on trading transactions will give rise to a charge to tax while balances which were created on capital transactions will not.
order to confirm if a charge to tax may arise it will be necessary to review the circumstances of the transaction which created the loan.

The forgiveness of the debt may give rise to an obligation on the Creditor to raise a VAT credit note. This may give rise to a loss of a VAT input credit for the Debtor even where the two parties are related parties. It will be necessary to carefully consider the VAT consequences for both the creditor and the debtor upon the forgiveness of a debt.
3. Changes in the legal status of a company

Liquidation

The appointment of a liquidator to a company will have taxation consequences for the company and may also have unforeseen consequences for the related group companies. The tax consequences of the appointment of a liquidator include:

- A change in the corporate tax compliance obligations of the company placed in liquidation (i.e. the end of an accounting period.)

- Certain liabilities, including certain tax liabilities become preferential.

- The appointment of a liquidator to a group member company is the occasion of the company ceasing to be the owner of its assets thereby breaking the group relationship between it and any of its subsidiaries. This may give rise to the claw-back of tax reliefs previously claimed and other taxation consequences.

Once placed in liquidation any profits of the company will still remain within the charge of corporation tax or capital gains tax. Losses generated by the company in the period to the cessation of its main activity will only be available for off-set against this taxable income in limited circumstances.

Receivership

For taxation purposes a receiver will act as an agent of a company. Where the receiver disposes of an asset or undertakes any other transaction the company will be deemed to have undertaken the transaction. Depending on the type of transaction undertaken the receiver may be required to pay the associated tax liability as he will hold the proceeds. In other cases the company may be required to account for the liability.

Examinership

The completion of an examinership process may result in a scheme of arrangement under which the liabilities of the company will be reduced. If this occurs a company is likely to recognise income equivalent to the reduction in the company’s liabilities in its profit & loss account.

It is important to note that the recognition of this income could give rise to a charge to tax. It will be necessary to consider whether this charge to tax may arise and whether the company has sufficient losses carried forward to avoid a cash tax payment. The scheme of arrangement may also give rise to VAT consequences for the company which should be considered in detail.

4. Maintaining a positive relationship with Revenue/Payment of Arrears of Tax

The Revenue currently charge interest at a rate of up to 10% on underpayments of tax. Prior to the contraction in the supply of credit this was seen as a prohibitive rate of interest. However, in the recent past a significant number of taxpayers have been required to prioritise commercial creditors.

The Revenue have provided guidance to taxpayers who are experiencing difficulties in meeting their tax payment obligations. The guidance stresses a number of key points:

- Revenue’s willingness to engage with a company to discuss the root of the difficulties.

- The requirement for the taxpayer to highlight the difficulty at an early stage.
The requirement for the taxpayer to identify the reason why the tax can now not be paid and the business plan which will allow for the discharge of the liability at a future point in time.

A Tax Inspector has the option to agree a phased payment plan with the taxpayer. During this period the Revenue will not seek to recover the entire debt at once but will continue to charge interest.

If the Inspector does not agree to a phased payment plan the Revenue will pursue the debt. The Revenue have a number of enforcement options open to them including action by a Sheriff, a Solicitor pursuing collection, attachment and liquidation.

It is important to note that in the case of a VAT group all of the members of the group are jointly and severally liable for any VAT underpaid by the group. As a result the Revenue may seek to recover the entire unpaid VAT amount from any company which is not the group remitter.

For further information:

A Guide to Financial Reporting Requirements - IAASA


Revised Guidance on the Duties of Auditors to Report Suspected Indictable Offences to the Director of Corporate Enforcement

Improvements to Financial Reporting Standards - FRC

Auditing and Ethics Standards Setters

Case decision escalation framework (CDEF) – Revenue.ie

Foreign effective rates – Revenue.ie

New time limits for repayment claims – Revenue.ie