

TAX OPTIONS OPEN TO ENTREPRENEURS



Mark Lonergan
HLB Nathans

When setting out on their own in business, entrepreneurs can choose between two possible tax avenues, depending on whether they opt to operate as a sole trader or a limited company.

Paul Dillon, tax director with Baker Tilly Ryan Glennon, said the different tax rates applicable to the profits of a company, as opposed to those of a sole trader, are a key consideration when making this decision.

“One of the main benefits of running a business through a company is the corporation tax rate. The current corporation tax rate is 12.5 per cent, as opposed to the top rate of income tax of 41 per cent of individuals,” said Dillon. “However, it should be noted that the 12.5% rate only applies to trading income. Passive income, such as rental and investment income, is taxed at 25 per cent.”

Another benefit of incorporation, Dillon said, is that a full deduction of pension contributions made by the company to the pension scheme can be claimed when calculating the corporation tax liability of the company.

Limited Liability

“In general, we would advise entrepreneurs to conduct their business through a limited liability company”, said Gerry Vahey, tax partner at Mazars. “Apart from the obvious commercial benefits of liability, there are several other advantages, including the option to defer tax payments by leaving profits within the company and the ability to make increased pension contributions”, he said.

“We’d advise most clients in the early stages to take the cash out of the company. Even though the tax is higher, they will have access to cash which they can use to invest personally.

New business owners often get caught up in focusing on the structure of the business rather than the business itself, according to Mark Lonergan, tax manager at HLB Nathans. In some cases, he said that it may not be necessary to register a company in the early stages.

“The rule of thumb traditionally is that a business when it generates more taxable profits than the owner needs for their annual income. There is no point in incurring the additional expenditure and responsibility to achieve a lower tax rate if there are no surplus taxable profits”, said Lonergan. “Another point to bear in mind is that,

if you are not making profits, the costs of filing returns and professional fees can be costly”.

Many business owners who decide to operate as sole traders have recently left PAYE employment, said Lonergan. “As a sole trader, you can write off losses against previous tax liabilities as a PAYE earner”. Before taking the decision to incorporate, Dillon said business owners should be aware of the tax disadvantages of operating a business through a company. “The assets of the company are trapped, so to speak, in the company and a double charge to tax will arise on the extraction of assets and income out of the company”, he said.

Tax Obligations

“Whatever structure you choose, make sure that you are registered for tax, you register your employees and file your returns on time”, said Lonergan. “If you don’t do the housekeeping, you will be liable for tax interest and penalties and you will be getting off on the wrong footing with the Revenue Commissioners”, he said.

“Tax issues are complex. You need to get professional advice at the outset to conduct a full consideration of the proper structure and put the necessary registrations in place”.

There is a five per cent surcharge if the annual return is up to two months late, subject to a maximum of €12,695 and a 10 per cent surcharge if the return is over two months late, subject to a maximum of €63,485.

Companies with employees must register for PAYE and PRSI. “It should be noted that if you set up as a company, the company must register as an employer and operate PAYE / PRSI on the pay of directors, even if there are no other employees”, said Dillon.

There is no obligation to register for VAT if annual turnover exceeds or is likely to exceed €35,000 for businesses supplying services or €70,000 for businesses supplying goods. These limits will increase to €37,500 in the case of services and €75,000 in the case of goods from May 1, 2008.

Revenue permits business owners in a start-up situation to register before they commence trading, said Dillon. This allows the individual to reclaim VAT on pre-trading expenses.

Vahey said business owners particularly those involved in the construction industry, needed to watch out of the relevant contracts tax. Failure to deduct the relevant contracts tax can result in the Revenue Commissioners claiming the 35 per cent contracts tax that should have been deducted plus interest and penalties.

Currently, Dillon said that relief was available for intellectual property assets. “These include capital allowances regimes for software and patents. There are also reliefs available for know-how and scientific research. However, there is no relief for IP assets such as goodwill, trademarks and brands. Consideration is being given to providing a relief for goodwill”.

Lonergan said that a welcome amendment to the tax system, introduced in the recent budget, was the €50,000 increase in the preliminary corporation tax threshold – allowing applicants to apply as a “small company” – to €200,000.

Companies that qualify as a small company can choose to base their preliminary tax calculation on 90 per cent of their anticipated corporation tax liability of the previous accounting period. The former option is easier to administer as business owners do not have to project income for the current year.

Tax Incentives

The Business Expansion Scheme (BES) can be a useful mechanism for start-up companies to raise capital, said Gerry Vahey, tax partner, Mazars. “In recent years, the limits for BES have increased where qualifying companies can raise up to €2 million which qualifies for tax relief, he said.

“Investors who subscribe for qualifying shares can claim a tax deduction against all income for the cost of their investment subject to a maximum of €150,000 in any one year; any unused amount is carried forward to for use in future years”.

Vahey said seed-capital investment relief allowed a person who set up a new company to claim a deduction of up to €600,000 for the subscription of shares, subject to a maximum amount of €100,000 each year. Mark Lonergan said the Minister for Finance had announced changes to make it easier for companies involved in recycling to raise funds under the BES.

“The previous requirement for such companies to have grant aid is being replaced with a requirement for their business proposals to be certified by an industrial agency or County Enterprise Board. As this is state aid, the minister will need to get approval from the EU before it can be implemented,” he said.

In order to incentivise research and development expenditure, the government has introduced an R&D corporate tax credit. “This was introduced a number of years ago and effectively provides for an additional corporation tax credit of 20 per cent of any incremental expenditure over what was incurred in 2003”, said Vahey.

“In effect, the corporation tax benefit of qualifying research and development expenditure is 32.5 per cent, when you take into account the fact that the expenditure is deductible at 12.5 per cent and the additional credit of 20 per cent”, he said.

“Entrepreneurs and owner managers should review what expenditure they believe may qualify as this is a valuable relief and can reduce a company’s corporation tax liability significantly”.