Tax Exemption for New Start-Up Companies

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1. Introduction

The government introduced this incentive to stimulate economic activity. In the Finance Act (no.2) 2008 a three year exemption from corporation tax for new companies which commenced to trade in 2009. It was extended in the FA 2010 to include companies which commenced to trade in 2010.

Effectively a qualifying company can generate trading income and capital gains up to €320,000 for the first three years of trading and not pay any Corporation Tax. This exemption does not apply to passive, ie non trading income.

Example

A new company commenced trading on1st January 2010. It has trading income for the first year of €250,000 and deposit interest of €35,000.

The company will not be liable to corporation tax on it's trading profits. It will pay tax at 25% on the deposit interest of €35,000.

Set out below are the details of the scheme, including the maximum and marginal tax-exempt amounts allowable, the time limits for the relief and the provisions relating to the de minimis grant aid requirements.

2. Companies that the Relief applies to

The legislation for this corporation tax exemption is contained in Section 486C of the Direct Taxes Acts.

Section 486C provides relief from corporation tax in their first 3 years of operation for new companies:

- that are incorporated on or after 14 October 2008,
- which commence a qualifying trade in 2009 or 2010, and
- whose corporation tax liabilities do not exceed specified levels.

The company must be incorporated anywhere in the EEA (ie the European Union plus Iceland, Liechtenstein and Norway.)

The relief applies to profits from a qualifying trade and to chargeable gains arising on the disposal of "qualifying assets".

A qualifying trade does **not** include

- a trade which was previously carried on by another person or formed part of another person's trade,
- a trade of dealing in or developing land or exploration and extraction of natural resources, or
- a trade consisting of "service company" activities as defined in section 441 of the TCA 1997. Service companies include close companies whose businesses consist of the carrying on of a profession or the provision of professional services, or of exercising an office or employment. Service companies also include businesses that provide services to professionals.

The relief therefore does not apply to all newly incorporated companies. Specifically excluded are companies subject to the 25% rate of corporation tax and professional service companies.

As mentioned above the relief does not apply to "service" companies. Section 441 defines a service company as a close company:

a) whose business consists of or includes the carrying on a profession or the provision of professional services;
b) which holds or exercises an office or employment;
c) whose business consists of or includes the provision of services or facilities of whatever nature to or for:
   i. a company within the categories (a) and (b) described above,
   ii. an individual or partnership which carries on a profession,
   iii. a person who holds or exercises employment,
   iv. a person or partnership connected with any of the above.

For a more detailed discussion on Service companies please see Tax Briefing 48.

"Qualifying assets" are defined as relevant assets of the qualifying trade which are disposed of in the three year period. "Relevant assets" are assets used directly on the trade that would incur a liability to Capital Gains Tax.

Finally, note also that to be a 'qualifying trade' the company must also come within the scope of the EU de minimis aid Regulation. (See paragraphs 4 and 5 below.)

3. How much relief is available and how does it work

To qualify for full relief the total corporation tax payable by a company must not exceed €40,000. A qualifying new company with a corporation tax liability up to this amount will have its corporation tax liability reduced to nil. The maximum relief over 3 years is €120,000 (€100,000 for companies engaged in the transport sector).

Total corporation tax is defined as all corporation tax that is chargeable for the period but excluding income tax. Therefore it would include corporation tax on passive income and the close company surcharge but excludes income tax withheld, for example withholding tax on a patent royalty.

To quantify the relief available the company must calculate its Relevant Corporation Tax (RCT), which is the total corporation tax (as outlined above) less the following;

- Tax on income at 25% rate
- Close Company surcharges
- Tax on chargeable gains

The RCT is then applied to the qualifying trade income over total income (defined as total income excluding income charged at the 25% corporation tax rate). This will the relief that can be deducted from the corporation tax charge.

Example

ABC Ltd commenced trading on 1st January 2010. It's results for the first 12 months of trading were as followings;

Trading profit	€80,000
Patent	€10,000
Deposit Interest	€17,000

Adj Gain on disposal of shares €20,000 (these were not qualifying trade assets)

Calculation of Corporation Tax for the year ended 31st December 2010

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Case I	80,000
Trade Charges	(10,000)
Case III	17,000
Total Income	87,000
Adj Gain	20,000
Total Profits	107,000

Case I 80,000- 10,000 * 12.5%	8,750
W/hold tax on patent 10,000 * 20%	2,000
Case III 17,000 * 25%	4,250
Gain 20,000 * 12.5%	2,500
Tax Payable	17,500
Relief (note 1)	(8,750)
Final Tax payable	8,750

Note 1

Calculation of relief

Total Corporation Tax = 17,500 – 2,000(w/hold tax) = 15,500 therefore relief is available

Relevant Corporation Tax = €15,500- €4,250(tax on passive income) - €2,500(tax on gain) = €8,750

$$8{,}750 * \frac{80{,}000-10{,}000}{80{,}000-10{,}000} = 8{,}750$$

Marginal Relief

There is a sliding scale of marginal relief where the corporation tax liability for a 12-month accounting period exceeds €40,000 but is less than €60,000. In that instance the corporation tax payable by the company for the accounting period is reduced to an amount determined by the following formula:

3 x (T-M) x (A+B)/T

where:

- T is the total corporation tax payable by the company for the accounting period,
- M is the lower relevant maximum amount (i.e. €40,000),
- A is the corporation tax payable by the company for the accounting period so far as is referable to income from the qualifying trade for the accounting period, and
- B is the corporation tax payable by the company for the accounting period so far as is referable to chargeable gains on the disposal of qualifying assets of the qualifying trade.

Example

ABC Limited commenced trading on 1st January 2010. Its Total Corporation liability for the year ended 31st December 2010 is €55,000. The charge is made up as follows;

Tax on qualifying trade	€28,000
Tax on passive income	€21,000
Tax on qualifying assets sales	€6,000

As the Total Corporation tax is over €40,000 it cannot claim the full exemption. However, the company can claim marginal relief;

3 * (€55,000-€40,000) * (€28,000+€6,000)/€55,000 = 27,818

Final Tax payable €55,000 – €27,818 = €27,182

pany's tax liability is €41,000 (all attributable to income from a qualifying trade), it will get relief of €38,000 and will pay €3,000, calculated as follows:

3 x (€41,000 - €40,000) x €41,000/€41,000 = €3,000

4. Claims for relief

A claim for relief must be made on the CT1 Form. The claim must specify the amount of the relief being claimed for an accounting period. The relief must be within the limits set out in section 486C.

Claims for 2010 can be made on the line provided at Panel 9 on the CT1 form.

Claims for 2009 should be included at Panel 9 on that return under 'Other reliefs', specifying that it is section 486C relief that is being claimed.