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Structuring Acquisition Of Irish M&A Targets – Creating An Asset Deal To Maximise Intellectual Property Tax Shelter

Introduction

Internationally, many corporates have structured their European Middle East and African (“EMEA”) hubs from an Irish base so as to exploit the Irish 12.5% corporate tax regime. As the M&A market reopens, private equity houses and multi-nationals are increasingly focused on acquiring these EMEA hubs contained within Irish corporates. The question arises as to whether the buyer should seek to acquire shares of the Irish corporate target or the trade and assets of the Irish corporate target.

This note highlights the advantages of structuring acquisitions as asset deals in the light of the extensive tax amortisation available under the Irish IP tax regime.

i. Share Acquisition

The acquisition of shares in an Irish corporate will attract Irish transfer tax, otherwise known as stamp duty, of 1% of the share consideration.

In certain circumstances, where the target is a trading group and the shares in target are owned by an Irish tax resident parent, the disposal can be structured to be free of Irish tax for the vendor.

The acquirer will not obtain Irish tax amortisation on its acquisition of share capital by reference to the underlying assets of the target.

ii. Asset Acquisition

An acquisition of certain trade and assets using an instrument which relates to anything done or to be done in Ireland attracts stamp duty at 6%. It should be noted however that it is usual to structure an acquisition of trade and assets to minimise the impact of such a tax. For example, for instruments executed after 7 May 2009, there is a wide-ranging exemption for acquisition of intellectual property including goodwill directly attributable to patent, trade-marks, trade names, authorisation for medicines and other products, including rights derived from research before authorisation and licences relating to any of the above-mentioned.

A target will not sell assets if it gives rise to adverse tax consequences for the ultimate vendor. A sale of assets at a price in excess of their acquisition value will typically give rise to tax in the target at 25%. It may also give rise to balancing charges clawing back tax depreciation allowances previously claimed.



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The Irish tax code is unique in that it provides an ability for an Irish tax resident corporate owned by a resident of a country with whom Ireland has a double tax treaty (or an EU/EEA member) to migrate its residence tax-free, i.e. no exit charge. This means that where a vendor causes a target to migrate its tax residence prior to sale, such a target may sell its intellectual property free of Irish capital gains tax at 25%.

iii. Asset Acquisition – Irish Tax Relief for Acquirer

For intellectual property acquired in Ireland and actively licensed to companies operating both locally and overseas, Ireland applies a 12.5% corporation tax rate on licence fees, royalties and other income received. This rate may be eroded further by;

- Tax amortisation for acquired IP,
- Research and development credits, and
- Withholding tax credits.

Tax Amortisation for IP

Ireland has one of the world's most progressive regimes for generating tax amortisation for intellectual property. Tax amortisation over 15 years or the accounting life of the intangible asset can be claimed against the income generated from the intangible asset, subject to the tax depreciation and related finance costs being capped at 80% of the related IP income in the relevant accounting period. Any unused tax depreciation can be carried forward for offset against related IP income in future tax years. For example, if an Irish IP hub incurs, say, €10m spend on a 5 year licence to exploit a secret formula or process in the EMEA region, it will get a tax allowance of at least €2m per annum. The presence of tax amortisation can reduce the effective tax rate on IP income to 2.5%

The definition of expenditure on intangible property qualifying for tax amortisation includes:

- (a) any patent, registered design, design right or invention,
- (b) any trademark, trade name, trade dress, brand, brand name, domain name, service mark or publishing title,
- (c) any copyright or related right within the meaning of the Copyright and Related Rights Act 2000,
- (d) certain computer software or a right to use or otherwise deal with computer software,
- (e) plant breeders' rights,
- (f) secret processes or formulae or other secret information concerning industrial, commercial or scientific experience, whether protected or not by patent, copyright or a related right, including know-how,
- (g) any authorisation for, and rights derived from, certain medicines or any product (not a medicine) of any design, formula, process or invention,

Irish tax amortisation also includes expenditure on the grant of licences over intangible property. Hence, a Cayman IP company may wish to grant for an arms length sum a licence over, say, EMEA rights, to an Irish hub which in turn licences the IP to subsidiaries operating in the EMEA.

Research and Development Credits

The Irish tax charge on intellectual property income can be eroded below 2.5% by reference to incremental expenditure on research and development throughout the EU. Ireland offers a tax credit equivalent to 25% of incremental R&D expenditure incurred above the base year spend of 2003. This credit can be set against Irish corporation tax or in certain circumstances, repaid. The definition of research and development is wide and extends to certain financial services innovation.



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Withholding Taxes

Numerous international groups are using Ireland as their international IP hub. Strategically, Ireland offers a platform to generate licence fees with withholding taxes minimised by reason of Ireland's treaty network with currently 62 countries. Where withholding applies (whether supplied in a treaty or non-treaty jurisdiction), credit for foreign tax can be set against the Irish corporation tax liability.

Conclusion

A pre-sale reorganisation can significantly increase deal value for a foreign vendor of an Irish target. This is achieved by causing the Irish target to cease its Irish residence and enable a tax free sale of assets that attract Irish IP allowances at a value that reflects the goodwill in the target business. The resultant acquisition provides a strong tax shelter against future profits. The target assets will probably need to be isolated from the trade of target to avoid capital gains tax on assets used in an Irish trade. In circumstances, existing asset deals can be structured through Ireland to create worldwide tax shelter.

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