FEATURE ARTICLE – IRELAND

Business Asset Relief and Excess Cash

In this article, Mark Doyle and Gearalt O'Neill discuss the impact of cash balances on a claim for CAT Business Asset Relief.

Introduction

Can a company have too much cash? If that question is posed to a Revenue Inspector in the context of a review of a claim for CAT Business Asset Relief, the answer may well be, yes!

During the lifecycle of a company, cash generated can be used within the business to improve infrastructure, invest in improved systems, settle creditor balances, etc. However, when the cash being generated within a business is surplus to requirements, this cash can end up being regarded as "excess cash" from a Business Asset Relief perspective.

Business Asset Relief

Broadly, Business Asset Relief reduces the taxable value of relevant business property by 90 percent. However, where a company is deemed to hold "excess cash", this can dilute the proportion of the share value that qualifies for Business Asset Relief on a gift or inheritance of shares in a company; thereby increasing the potential CAT liability.

Business Asset Relief does not apply to any assets held by a company that were not used wholly or mainly for the purposes of the company's business throughout the 2 years prior to the gift/inheritance. Such assets are regarded as excepted assets. Thus, it could be argued that cash held by a company above day to day working capital is not being used for the purposes of its business and therefore does not qualify for Business Asset Relief when shares in the company are gifted or inherited. Where a company holds excess cash, the value of the shares eligible for Business Asset Relief is proportionately reduced and the share value attributable to excess cash is subject to CAT.

To illustrate the impact of this, let's consider the following scenario: James is the 100% shareholder of ABC Ltd and is transferring his full shareholding to his son, Michael. ABC Ltd is a qualifying company for Business Asset Relief purposes and the company is valued at €5 million.

Where ABC Ltd has no excess cash, the taxable value of the shares received by Michael is €500,000 (assuming full Business Asset Relief is available). However, where ABC Ltd has excess cash of, say, €1 million, the taxable value of the gift is increased to €1.4 million, illustrated as follows:

	Fully Qualifying	Excess Cash
	€	€
Total Value of Gift	5,000,000	5,000,000
Value of Qualifying Assets	5,000,000	4,000,000
Business Relief (Qualifying Assets x 90%)	(4,500,000)	(3,600,000)
Taxable Value of Qualifying Assets	500,000	400,000
add		
Taxable Value of Non-Qualifying Assets	-	1,000,000
Taxable Value	**500,000**	**1,400,000**

How to identify excess cash

There is no "one size fits all" approach to determining what a company must hold for working capital purposes. However, most companies have a figure below which the directors would not be comfortable reducing their cash balance while still remaining confident that the company can meet its debts as they fall due; this figure should be worked-out over a number of years taking into account future known liabilities. To this figure may be added a reasonable contingency plus a further contingency for case specific factors and perhaps a recession. Further provision may also be included for identified required finance for capital plans etc.

Working out the excess cash figure for a company is not an exact science and two accountants set the same task could reach different conclusions.

Legislative Guidance

While there is not much by way of Revenue guidance on the matter, we can take some direction from two relevant Tax Appeals Commission cases – 132TACD2021 and 85TACD2023.

132TACD2021

In this case the Appellant received shares in a company whose main business was the operation of a supermarket. The company had been in operation for many years and held large cash reserves, investment assets and properties (some of which were let to employees). Revenue's position was that these assets were not used for the company's business and therefore were excepted assets for the purposes of Business Asset Relief.

The Appellant disagreed, noting that part of the cash was required for the day-to-day running of the business and upgrading of plant and machinery. The balance of the cash, the investment assets and the properties were all held as part of a plan to expand the company's supermarket premises.

The Commissioner held that, in principle, assets set aside for a building development could qualify as an asset "used for the purpose of the business". However, it is critical that the purpose is real and the asset genuinely used to that end.

In this case there was a long history of the company acquiring surrounding property, seeking planning permission and expanding its supermarket premises. The properties were acquired with the intention of redeveloping the properties for the purposes of the supermarket business. While some properties were let to employees in the meantime, this was a means to allow the supermarket to maintain additional staff for its main trade. The letting activity did not dilute the main purpose of those properties. This was supported by the fact that the properties were not actively marketed and the employees were asked to vacate once planning permission was imminent.

The Commissioner accepted that the cash was required for the purposes noted by the Appellant. In fact, the cash reserves were not sufficient and the company needed substantial loan facilities when the development project commenced. Thus, it was clear that the cash reserves were not surplus to requirements.

Given the evidence provided by the Appellant and the substantial work demonstrated over numerous years, the Commissioner was satisfied that the planning for the development began more than two years prior to the share transfer. Therefore, as the documented purpose to which the assets were to be used was clearly real and the assets genuinely used to that end, they qualified for Business Asset Relief.

85TACD2023

In this case, the Appellant received two gifts from his father consisting of shareholdings in two separate companies – the first company was part of a group while the second company was unconnected to this group. The Appellant met the conditions of Business Asset Relief in respect of both gifts. However, Revenue sought to treat 75 percent of the cash held by the first company's group as an excepted asset.

Both parties referred to case 132TACD2021 in their submissions. However, the Commissioner noted that he did not regard such an analytical approach as necessary to determine whether Business Asset Relief applied in this case.

As noted previously, relevant business property does not include shares in a company whose business is wholly or mainly making or holding investments. In reviewing the group's cash position, the Commissioner noted that the cash was held in current or short-term deposit accounts; therefore, those balances did not constitute the "making or holding of investments". Consequently, the cash was not an excepted asset for Business Asset Relief purposes.

The Commissioner noted that nothing found in legislation supported Revenue's position requiring the Appellant to pinpoint the use to which the entirety of the company's funds will be put. In addition, the Commissioner noted that such a subjective analysis could easily be displaced by the Appellant stating that the funds are required by the company for a rainy day or to grow the business etc.

The Appellant confirmed that some of the funds related to advance payments for work in progress while the balance was to hedge against foreign exchange risk, bankroll the large projects the company was involved in and grow the business without requiring substantial bank debt. In conjunction with a review of the group's balance sheets, the Commissioner accepted the Appellant's explanation and concluded that the assets were used by the business wholly or mainly for the purposes of the business throughout the last 2 years.

Conclusion

As shown above, what constitutes excess cash in a company is very much a subjective concept. A company may build up its cash reserves to take advantage of supplier discounts, bulk-buy stock, build new facilities etc. From a commercial perspective, these are legitimate reasons for cash to be built up within a business and based on the cases above, should not result in a dilution of Business Asset Relief.

It is best practice to maintain records within the company outlining the planned cash usage and documentary evidence should be retained. However, it should be noted that the plans must be legitimate, actively pursued and altered where the commercial reality dictates. Where these practical measures are put in place, it should be possible to maintain cash within a company for future use without jeopardising Business Asset Relief on a future gift or inheritance of shares in that company.

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