MBOs and the European Communities (Protection of Employees on Transfer of Undertakings) Regulation 2003

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Introduction

Helen Whelan referred earlier to a number of issues that must be considered in Management Buy Outs (MBOs).

The European Communities (Protection of Employees on the Transfer of Undertakings) Regulations 2003 ("the Regulations") are of particular relevance where MBOs are by way of asset purchase. MBOs through share purchase are not affected by the Regulations.

The Regulations came into force on 11 April 2003 and succeeded two earlier regulations that failed to implement properly the EEC Acquired Rights Directive 1977 ("The Directive"). The Directive was introduced to protect the rights of employees in the case of transfer of ownership or the merger of companies.

In light of the commitment in the Social Partnership Agreement "Towards 2016" to enhanced enforcement of employment legislation, there is likely to be a greater need for companies involved in asset purchases to comply strictly with the Regulations. Accordingly it is opportune to review the impact of the Regulations.

Application

The Regulations apply to the transfer (a sale, merger, etc.) of an economic entity (normally a company) whether in public or private ownership and whether acting for profit or gain. The Regulations can in some instances apply to property transactions. They extend to any person employed in the company that is the subject of sale.

Protection

The new employer is required to uphold the contractual terms of the employees acquired with the company and that includes obligations set out in any Collective Agreement at the date of the sale. The new employer must also protect the rights of the new employees under any Pension Scheme operated by the previous employer.

An employee's contract cannot be terminated by reason of the sale, but terminations are allowed for economic, technical or organisational reasons. This in effect means terminations on the grounds of redundancy are allowed but they must be genuine redundancies.

It should be noted that any attempt to impose less favourable working conditions or terms, than those previously held by the transferred employees could give rise to an action for constructive dismissal.

Information and Consulation

Both the original employer and the new employer must inform the representatives of the employees effected by the sale of:

(a) The date of the proposed sale;

(b) The reasons for the sale;

(c) The legal implications;

(d) Any measures envisaged in relation to the employees as a result of the sale.

Both the original and the new employer must give this information to the employees' representatives not later than thirty days before the sale and in any event in good time before it occurs. Employees can be represented by a Trade Union Official, Staff Association representative or a person chosen by the employees to represent them. In the latter case, an employer is required to allow and assist employees in the election of an employee representative.

Where measures are envisaged, employers are required to consult the employees on those measures with a view to reaching an agreement. Agreement on what is proposed is not required, but the negotiations must be genuine.

Enforcement

All disputes arising out of the sale can be referred to a Rights Commissioner. Written notice of the complaint/ dispute must be made to the Rights Commissioner within six months of the alleged date of the contravention of the Regulations. The time limit in certain circumstances can be extended for a further period of six months.

The Rights Commissioner will give both parties an opportunity to present their cases orally. Thereafter the Rights Commissioner may:

(1) Declare that the case was not well founded;

(2) Require the employer to comply with the Regulations and for that purpose to take a specific course of action or;

(3) Require the employer to pay the employee compensation.

There is a right of appeal from the decision of the Rights Commissioner by either party to the Employment Appeals Tribunal. The Tribunal can affirm, vary or set aside the decision.

Conclusions

This article merely emphasises the greater need for companies in asset purchases to comply with the Regulations.

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Management Buyouts

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Management buyouts (MBO) by executives are becoming increasingly common. In simple terms, an executive team purchases a Business from its owners.

If you are contemplating an MBO you need to be aware of the issues you face, in terms of the commercial, legal and tax issues. You must consider the consequences of failure in the venture and weigh up the resulting possible risks and rewards. An MBO which is not structured correctly from the outset may have serious consequences up to and including the failure of the bid itself.

Who wants what in an MBO?

The owners of the company want the best price for the company. You, the executive team wish to purchase the company for as little as possible. A bank that is lending money to you requires reliable security. A venture capitalist willing to maximise their investment. Balancing these varied expectations can result in a complicated negotiating process. It is essential for each party to obtain independent legal and tax advice from the start in order to avoid unnecessary cost and expense.

Changing Roles

An MBO will often mean that your role changes from an employee to that of director. This change in roles imposes additional duties on you: director's duties. By law, a director is under a duty to act honestly in the best interests of the company. A director is considered to be a fiduciary: that is in a relationship of trust with the company.

One conflict of interest that may arise is when a member of the executive team is also a director of the company. If this director is taking a stake in the buyout, he must take care not to participate in the discussions or voting of the board in relation to the MBO.

In an MBO the most relevant fiduciary duty for a director is not to profit from the relationship with the company. Directors must take care to make decisions in connection with the MBO that are strictly in the best interests of the company and not take decisions which just facilitate the MBO or their own interests. Directors are also under a general duty of confidentiality to a company. In a MBO, therefore, the consent of the company and the sellers should be sought prior to entering into discussions with any financial backer, particularly if those discussions may entail disclosure of confidential information.

So how do you structure your buyout?

In most MBOs, a new company is incorporated to acquire the business that is being purchased. We recommend that all the parties taking a stake in the new company enter into a share subscription and shareholders' agreement. This agreement sets out in detail the investment obligations of the parties and the mechanics of the ongoing relationship between the management and any investors. Often, the shareholders' agreement will place restrictions on certain executive decisions so that they may only be taken with the consent of all of the shareholders. Share subscription and shareholders agreements are complex documents and all the parties should seek appropriate legal advice before entering into such agreements.

In addition, the executive team should enter into service agreements with the new company. Again suitable professional advice should be sought before an employment contract is signed.

Possible pitfalls in financing

So now your bank has agreed to lend you the money you need to purchase the business. Is there anything else you need to think about? If the loan is to be secured on the assets of the business or the new company, this raises the thorny issue of Section 60 of the Companies Act 1963. This section prevents a company from giving assistance in the acquisition of its own shares. In private companies, this prohibition may be overcome by the directors making a declaration of solvency of the company and the shareholders authorising the transaction. This is called the "white wash procedure". Again, legal advice should be sought as soon as possible.

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Formal requirments for company websites and company electronic communications

The Minister for Enterprise, Trade and Employment has recently announced that the disclosure rules with respect to Company particulars on certain company documents, have now been extended to company websites, emails and other forms of electronic communication in respect of Limited Liability Companies. These new measures came into effect from the 1st April 2007.

The objective of this regulation is to provide consumers and others with basic information on companies with which they may wish to do business.

New Disclosure Regulation – Soft Copy documentation.
Websites, emails and all other forms of electronic communication from Limited Liability Companies are now required to show the following:

- The Company name and the Company's legal form i.e. XY Limited.
- The place of registration of the company, its registered number and the address of the registered office. i.e. Registered in Ireland No. 99966.
- In the case of a company exempt from the obligation to use the word "limited" as part of its name, the fact that it is a limited company;

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Passing on the Family Business to the Next Generation

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Are you thinking of passing on your business to the next generation? If you carry on your business as a sole trader, in a partnership or under the guise of a private company, there are a number of options which require careful consideration. You might contemplate leaving your business in your will (known as a bequest) to your chosen successor(s), or alternatively you may gift it to them during your lifetime.

You should be aware that transferring your business will trigger significant tax charges on all beneficiaries and possibly for you as well. When passing on a family business – be it a sole trade, partnership, or private company – Capital Gains Tax, Capital Acquisitions Tax, stamp duty and VAT may all arise. However, there are a number of tax planning mechanisms which may be utilised to reduce or even eliminate the tax payable by a beneficiary upon the receipt of a gift or inheritance. This article will briefly outline some of these tax planning procedures, and their effectiveness.

1. Transferring Business by Will / Gift

Capital Aquisitions Tax (CAT) at the rate of 20% (after the deduction of any tax-free allowances), will be charged on the value of any benefit received by the beneficiary. Even if you estimate the amount of CAT payable at the date of making your will, the value of your business may have increased substantially between then and your death, which could result in an unforeseen increase in the amount of CAT chargeable. Thus bequeathing the business in your will may not be the most efficient way of making proper provision for the next generation.

If you choose to sell your business to your chosen successor(s), you will incur Capital Gains Tax at the rate of 20% on the difference between the sale price (market value) and original cost of acquisition of the business. The purchaser may also be liable to a charge for stamp duty of up to 9%.

(a) Tax Free Thresholds

Depending on the relationship between you (the person making the bequest under your will or passing on the gift during your lifetime) and the beneficiary(ies), different levels of benefit can pass before a liability to tax will arise. For example, each of your children may receive a gift or inheritance worth €478,155 completely tax-free. Your brothers, sisters, nieces or nephews may take a gift or inheritance valued up to €47,815 before liability to CAT will arise. There is a tax-free threshold of €23,908 for gifts to any person not related to you.

Your relationship to the beneficiary is therefore central to assessing the CAT liability: a gift or bequest to your child may fall outside the tax net completely, whereas a gift or bequest of similar value to an unrelated individual will be more severely taxed. If you are thinking about whether or how to pass on your business, you should consider how much of the benefit will be taxable and thus how much the gift will be worth in the hands of each individual.

(b) Spousal Exemption

An inheritance taken by a spouse is automatically exempt from CAT.

(c) Business Property Relief

If one of your beneficiaries is interested in carrying on the business as a going concern, a substantial tax saving known as "Business Property Relief" may be availed of.

If this relief can be claimed, the market value of the business assets is reduced by 90%. For CAT purposes, only 10% of the true market value is taxable, giving rise to substantial savings for the beneficiary. This relief may only be claimed by beneficiaries who will continue to run the business after your retirement or death. In order for the relief to apply, the relevant business property must be held by the benficiary for two years in the case of an inheritance or five years in the case of a gift.

(d) "Favourite Nephew" Relief

"Favourite Nephew Relief" may also be claimed which gives rise to significant tax breaks for the beneficiary. If your niece or nephew has worked on a full time basis in the business for a period of time prior to the gift or inheritance, and is then gifted or bequeathed property used in connection with the trade, the beneficiary is entitled to claim a higher tax-free threshold. This useful relief will increase the amount the

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beneficiary can take tax-free from €47,815 to €478,815.

The niece or nephew must work "substantially on a fulltime basis" in the business which has been interpreted as a 24 hour working week over last five years. The Revenue will judge each application for the relief on a case-by-case basis.

2. Tax Planning Before Death

Section 72 Policies:
If you intend to bequeath a large proportion of your business to a small number of individuals, you should carefully examine the tax consequences of these bequests. As a CAT liability will arise based on the value of the business or shareholding (less any tax-free threshold), the tax charge may be quite large, and it is possible that one of the beneficiaries may not have the necessary funds to pay this liability. This may leave him with little option but to sell. At the same time, the other beneficiaries may not be in a position to buy part of the business at short notice, which would mean that your business could fall into the hands of a third party - or even an active competitor.

In order to prevent the chances of this occurring, you should consider purchasing a special life assurance, called a "Section 72 Policy". On your death, the proceeds of this policy will discharge the CAT liabilities of the beneficiaries. This will ensure that your business need not be sold simply to meet the demands of the Revenue Commissioners.

3. Share Restructuring

If your main business asset is a company, you might consider changing the structure of the shareholding. You can continue to control the company, while simultaneously making provision for your intended beneficiaries. For example, you could decide to allot to yourself a category of shares which would mean that the business and management decisions would continue to be taken by you. A separate category of shares on the other hand could be gifted to your successors entitling them to share in any dividends of the company. In this manner, while you will retain control over all the day-to-day running of the company, you are already making provision for your future successors.

This type of arrangement would be particularly useful where those intended to benefit are still quite young, and you would prefer to oversee the running of the business for the time being. Further, if your business has experienced good growth in recent times, and it has a favourable outlook for the future, transferring shares at an earlier date will obviously attract a smaller tax liability than at a later date, when the shares may be conceivably worth much more.

4. Retaining "Keymen"

You may not have realised how much dependence you place on some of your employees: there may be an individual who has worked in the company over a period of years and who is now by virtue of his hands-on participation and extensive know-how seemingly indispensable. If your children have yet to gain the requisite business acumen to effectively run the company, you might consider allowing this "keyman" buy into the business. This may be achieved by valuing the company, estimating future growth and offering him the opportunity to buy a portion of the shares. This will give your "keyman" a stake in the business and will help foster future business growth while at the same time allowing your children to gain relevant experience to run the business later.

5. Conclusion

This article merely outlines some of the issues which you should consider before transferring a business. As tax law changes annually, specialist tax advice should be sought before deciding how and when you will pass on your business. In doing so, it is crucial to outline your intentions, in order for you to obtain the most effective legal and tax advice.

- If any reference is made to the share capital of the company on any document, the reference shall be to the paid-up-share capital only.

Current legislation (unless otherwise exempt) requires all limited Liability Companies to show the following on their business letters:

- The name of the company and the company's legal form;
- Christian name, surname, initials used (if applicable), former name and nationality (if not Irish) of every Director or shadow Director.
- The place of registration of the company, its registration number and address of its registered office;
- In the case of a company exempt from the obligation to use the word "limited" as part of its name, the fact that it is a limited company;
- If any reference is made to the share capital of the company on any hard copy document, the reference shall be to the paid-up-share capital only.

All Limited Companies are required to show the above information on all order forms for goods and services with the exception of the names and nationality (if not Irish) of all directors. In addition the name of the company is obliged to be stated on all other hard copy documents including cheques, invoices and receipts.

Consequences of breach
Any persons or company who is convicted of an offence under this new regulation shall be liable, on summary conviction, to a fine not exceeding €2,000. If convicted of such offence, a person who continues contravening the regulations shall be liable, on summary conviction, to a fine not exceeding €100 for each day on which the offence so continues.

Unlimited Companies
Disclosure requirements for unlimited liability companies and branches of foreign registered companies differ from the regulations concerning Limited Liability Companies.