

Notes for Guidance - Taxes Consolidation Act 1997

Finance Act 2020 edition

Part 13

Close Companies

December 2020



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Part 13 Close companies

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PART 13 CLOSE COMPANIES

CHAPTER 1 *Interpretation and general*

Overview

This Part is designed to counter the avoidance of income tax at the higher rate by means of the device of allowing the profits of close companies to be accumulated rather than distributed to shareholders in whose hands the distributions would attract income tax at the higher rate. The Part does this by imposing a surcharge at the rate of 20 per cent on the undistributed after-tax investment and estate income of close companies (see *Chapter 2*). *Chapter 1* of the Part is supplemental to *Chapter 2* and is concerned with defining, in the first instance, what is meant by a close company (*sections 430 and 431*). The Chapter also contains a number of sections which provide for matters subsidiary to the meaning of “close company” (*sections 432 and 433*) and definitions for the purpose of the close company surcharge imposed by *section 440 (section 434)*.

430 Meaning of “close company”

Summary

This section gives the definition of a “close company”. Broadly speaking, a close company is a company which is under the control of 5 or fewer participators or under the control of its participators who are directors (however many such directors there may be). A non-resident company, an industrial and provident society, most building societies, a company controlled by the State, by another EU Member State or by the Government of a territory with which the State has a tax treaty and a company controlled by a non-close company are not regarded as close companies. Definitions of terms used in this section are to be found in *section 432* (meaning of “associated company” and “control”) and *section 433* (meaning of “participator”, “associate”, “director” and “loan creditor”).

Details

A “close company” is a company under the control of 5 or fewer participators or under the control of participators who are directors (however many such directors there may be). Excluded from the definition are —

- a non-resident company,
- a registered industrial and provident society,
- a building society within the meaning of the Building Societies Acts, 1874 to 1989,
- a company controlled by or on behalf of the State,
- a company controlled by or on behalf of a Member State of the European Communities (other than the State) or the government of a territory with which Ireland has a tax treaty, and
- a company to which *subsection (4)* applies or which comes under *section 431* which excludes certain companies with quoted shares.

A company is to be regarded as controlled by the State if it is controlled by persons acting on behalf of the State. Where a company is so controlled but would otherwise be a close company (for example, by reason of being controlled by 5 or fewer persons), it will not be regarded as a close company unless the persons in control are acting independently of the State. This rule also applies to those companies controlled by or on behalf of a Member State of the European Communities or by the government of a territory with which Ireland has a tax treaty. (2) & (2A)

The definition of close company is extended to include the case of a resident company where, on a full distribution, more than 50 per cent of the distributable income would be paid to 5 or fewer participators or to participators who are directors. (3)

A company is not to be regarded as a close company where control is in the hands of a company or companies which are not themselves closely held and the company could not be regarded as being under the control of 5 or fewer participators without including as one of the participators at least one company which is not a close company. References here to a close company are to apply also to a non-resident company which, if resident, would be a close company. (4)(a) & (5)

Excluded from the definition of a close company is a company which comes within that description only by reason of the extended “control” provision of *section 434(2)* and the participator is regarded as such only because the participator is a loan creditor of the company and is not a close company. (The effect of *section 432(2)* is that a person is taken to have control of a company if, in the event of the winding up of the company, the person would be entitled to receive the greater part of the distributable assets of the company). (4)(b)

Shares held by trustees are regarded as being in the beneficial ownership of a company which is not a close company where — (6)

- the shares are held in trust for an exempt approved retirement benefits scheme (within the meaning of *Chapter 1* of *Part 30*), and
- the scheme is not established wholly or mainly for the benefit of persons who are, or who are dependants of, employees or directors or former employees or directors of —
 - the company,
 - any company associated with it,
 - a company controlled by directors and/or associates of directors of the company, or
 - a close company.

The effect of this is that the scheme must be one established for the benefit of employees, etc of an unrelated company which is not a close company.

431 Certain companies with quoted shares not to be close companies

Summary

This section provides that a company is regarded as not being a close company if shares carrying 35 per cent or more of the voting rights are held by the public and the shares have been dealt in on a stock exchange during the previous 12 months. This rule applies only where not more than 85 per cent of the voting power is in the hands of the principal members. Shares held by a company which is not a close company or on trust for an approved superannuation scheme are regarded as held by the public, provided such

company or trust is not a principal member and does not come within certain specific exclusions. These exclusions are that shares are not treated as held by the public if they are held —

- by a director of the company or an associate of the director,
- by a company controlled by such persons,
- by an associated company, or
- as part of a fund which can be applied for the benefit of any directors or employees (past or present) – or their dependants – of the company or any connected company.

Details

The term “share” includes “stock”. (1)

The “principal member” of a company is defined by reference to the voting power which a person holds or which can be attributed to that person. If, on that basis, the person is one of the 5 persons holding the largest voting power and the person’s voting power exceeds 5 per cent, the person is regarded as a principal member. Where there are 2 or more equal holdings, the number of principal members is increased to more than 5 to bring in those equal holdings. (2)(a) & (b)

Example

Shareholder	Percentages of First company		Voting power held Second company	
A.	12		10	
B.	11	Principal	9	Principal
C.	10	Members	8	Members
D.	9		88	
E.	8		7	
F.	7		7	
G.	6		6	
H.	6		6	

In the case of the first company, although 8 persons hold more than 5%, only the first 5, A to E, count as principal members but not F to H. In the case of the second company, there is equality between some of the largest holdings and, therefore, the first 6, A to F, count as principal members but not G and H.

Any voting power which a member can exercise through a nominee, or through a company or companies of which the member or the member and associates of the member (including nominees of such associates) have control, is attributable to the member. Also attributable to a member is any voting power which can be exercised by the member’s associates or by their nominees. (2)(c)

A company is not regarded as a close company if shares carrying 35 per cent or more of the voting power (without reckoning fixed rate dividend shares, whether with or without further participating rights) are held by the public. This rule applies provided the shares have been dealt in during the previous 12 months on a recognised stock exchange. (3)

The above rule (*subsection (3)*) is not to apply to a company if more than 85 per cent of the voting power is in the hands of the principal members. (4)

Shares are regarded as held beneficially by the public only if they satisfy the conditions of *subsection (6)* and are not within the exceptions in *subsection (7)*. (5)

Shares are to be regarded as beneficially held by the public if they are held by a company which is not a close company or if they are held on trust by an exempt approved superannuation scheme or if they are not held by a principal member. (6)

Shares are not treated as held by the public if they are held — (7)(a)

- by a director or associate of a director of the company,
- by any company controlled by such director or associate or 2 or more such persons,
- by an associated company of the company, or
- as part of any fund the capital or income of which can be applied for the benefit of any directors or employees (past or present) – or their dependants – of the company or of any connected company.

The powers attaching to shares held by nominees are regarded as exercisable by the beneficial owners. (7)(b)

432 Meaning of “associated company” and “control”

Summary

This section defines “associated company” and “control” for the purposes of *Part 13*.

Details

Two companies are at any time associated if at that time or within one year previously one company controls the other company or both are under common control. Thus, if 2 companies have been associated, they will be treated as continuing to be associated for one year after they cease to satisfy the conditions. (1)

A person controls a company if the person is able to control or to acquire control, either directly or indirectly, of the company’s affairs. Without prejudice to the generality of this provision, a person is regarded as having control of a company if the person has or is entitled to acquire — (2)

- the majority of the issued share capital or voting power,
- such part of that capital as would entitle the person on a total distribution of income to more than 50 per cent of such distribution, or
- such rights as would entitle the person on a winding up or otherwise to more than 50 per cent of the distributable assets.

Where 2 or more persons together satisfy these conditions, the persons concerned are taken to control the company. (3)

A person is treated as entitled to acquire voting power, share capital or rights which that person is entitled to acquire in the future or will at a future date be entitled to acquire. (4)

The rights or powers of a nominee of a person are attributable to the person on whose behalf the nominee has those rights or powers. (5)

The rights and powers of a person and of the person’s associates are to be regarded as belonging to that person. The position is similar in relation to the rights and powers of (6)

any company which the person or the person and the person’s associates control. The rights and powers of nominees of an associate are also included but not those of associates of an associate. If this provision can be applied in such a way as to enable control of the company to be exercised by 5 or fewer participators, it is to be so applied.

Example

A company’s issued capital consists of 1,000 ordinary shares. A, B, C, D and E hold 100 shares each. This does not give them control of the company.

X who holds 10 shares is an “associate” of A and is also an associate of another shareholder, Y, who holds 50 shares.

Under *subsection (6)*, the 10 shares held by X may be attributed to either A or Y. If they are attributed to Y, the company still is not under the control of 5 or fewer participators. If they are attributed to A, then A, B, C, D and E between them will hold 510 shares and the company will be under the control of 5 or fewer participators. In these circumstances, the final clause of *subsection (6)* directs that these 10 shares must be attributed to A.

433 Meaning of “participator”, “associate”, “director” and “loan creditor”

Summary

This section defines the terms “participator”, “associate”, “director” and “loan creditor” as used in *Part 13*.

Details

A “participator” is a person having a share or interest in the capital or income of a company. This definition is enlarged on to include — (1)

- persons holding present or future rights to share capital, voting rights, loan capital (except in respect of an ordinary bank loan),
- persons holding rights to share in any distribution by the company,
- persons holding rights to share in any premium on redemption of loan capital, and
- persons holding any other rights under which the person could secure that present or future income or assets of the company could be applied directly or indirectly for the person’s benefit.

The definition of “participator” is without prejudice to any other provision in *Part 13* which requires that a participator in one company be treated as being also a participator in another company. This is required for — (2)

- *section 436(2)* which provides that a participator in a company which controls another company is also to be treated as a participator in that other company so that expense incurred by that other company in providing certain benefits for that person will be treated as a distribution,
- *section 438(7)* the effect of which is that the special charge to income tax on a close company which makes a loan to a participator will apply equally where the loan is made to a participator in a company which controls the company making the loan, and
- *section 439* which provides that the grossed-up amount of such a loan, when it is written off, will be treated as income of the borrower for the purpose of higher-rate tax: by virtue of *section 438(7)*. This applies whether the borrower is a participator in the company making the loan or a participator in another company which controls that company.

An “associate”, in relation to any person whether a participator or not, is the person’s (3)

close relatives, the person's partners, the trustees of any settlement made by the person or by any close relative and, if the person is interested in any shares or obligations of the company as a beneficiary of a trust or of a deceased person's estate, any other person interested in those shares or obligations. Excluded is a person entitled to benefit under a trust established for superannuation and allied purposes.

The term "director" includes any person in accordance with whose directions or instructions the directors are accustomed to act and any manager who alone or with associates owns or controls 20 per cent or more of the ordinary share capital of the company. (4)

Shares or voting power possessed by a person's associates can be attributed to the person even if that person is not a participator. The expression "either on his or her own or with his or her relatives" has a corresponding meaning. (5)

The term "loan creditor" includes any person holding redeemable loan capital issued by the company and any person to whom the company is indebted for money borrowed or capital assets acquired. It also includes any person who is entitled to a debt from the company in return for a right to receive income and any person who has received or will receive substantially more from the company than the value of the consideration the person has given the company. Excluded is a bank which is a loan creditor of a company in respect of a loan given by the bank in the ordinary course of its business. (6)

The definition of "loan creditor" is extended to include, to the extent of the person's interest, a person who has a beneficial interest in the debt or loan capital in question even though the person may not be the creditor. (7)

434 Distributions to be taken into account and meaning of "distributable income", "investment income", "estate income", etc

Summary

This section defines certain terms which are used in this Part for the purpose of identifying income liable to the surcharge under *section 440* on the undistributed investment and estate income of close companies and under *section 441* on the undistributed investment and estate income of service companies.

Details

The term "estate income" means income in the nature of rent from land or buildings which is chargeable to tax under Case III, IV or V of Schedule D. (1)

For the purposes of calculating surcharges "franked investment income" excludes distributions made out of exempt income (e.g. distributions out of profits or gains from stallion fees, stud greyhound service fees and occupation of certain woodlands).

The term "investment income" of a company is income other than estate income which would not, in the hands of an individual, be earned income within the meaning of *section 3* but does not include such income received in the course of trading. However, without affecting the meaning of "franked investment income", a dividend or other distribution by a company will not be regarded as "investment income" for the purposes of the close company surcharge if the close company to which it is paid would be exempt from tax on any gains on the disposal of those shares under *section 626B* at the time the dividend or distribution is being made.

"Relevant charges" are charges allowed under *section 243* other than charges of an excepted trade (i.e. charges allowed against non-trading income). These are deductible in calculating estate and investment income of a company for surcharge purposes.

The term “trading company” means any company which exists wholly or mainly for the purpose of carrying on a trade, and any other company whose income does not consist wholly or mainly of investment or estate income.

Subject to **subsection (3A)**, the distributions of a company for an accounting period are the sum of the dividends declared for the accounting period and paid or payable not later than 18 months after the end of the accounting period and any other distributions made during the accounting period. (2)

Apportionments of distributions on a time basis are to be made where the period for which a company makes up accounts and makes distributions is not an accounting period for corporation tax purposes. (3)

Where a close company pays a dividend or makes a distribution to another close company, the companies may jointly elect that the dividend or distribution is not to be treated as a distribution for the purposes of **section 440** (which imposes a surcharge on the undistributed investment and estate income of close companies). A notice to elect must be given to the Collector General of Revenue in such manner as the Revenue Commissioners may require. (3A)(a)

Where an election is made under **paragraph (a)**, the dividend or distribution is treated for the purposes of **section 440** as not being a distribution. This means that it is not to be taken into account as a distribution in determining the extent to which the dividend-paying company has distributed its profits. (3A)(b)

The dividend or distribution is treated as not being franked investment income of the receiving company. This means that, in determining whether the receiving company is liable to a surcharge, the dividend or distribution will not be counted as income of that company.

An election made under **paragraph (a)** is to be included with the company’s annual corporation tax return of profits for the accounting period concerned. (3A)(c)

For the purpose of the surcharge, the income of a company for an accounting period is to be computed exclusive of franked investment income and without regard to any losses, deficiencies, expenses of management or charges carried forward from an earlier accounting period, but after deducting any losses, deficiencies, expenses of management or charges of the accounting period. (4)

The “estate and investment income” of a company is — (5)(a)

- the sum of the franked investment income and the part of the company’s total income which is attributed to investment and estate income (that part is calculated by way of a formula),
- less the amount of non-trade charges and investment expenses.

The “trading income” of a company is the company’s total income (as calculated by **section 434(4)**) less—

- the estate and investment income as calculated above,
- charges of an excepted trade within the meaning of **section 21A**,
- non-trading charges and management expenses which could not be taken into account in computing the estate and investment income of the company (as calculated by this subsection).

“Distributable estate and investment income” is the estate and investment income less the corporation tax which would be payable on the income. The “distributable trading income” is the trading income less the corporation tax which would be payable on that income. (5A)(a)

In the case of a trading company the distributable estate and investment income is reduced by 7.5 per cent. **(5A)(b)**

Income is to be time apportioned to parts of accounting periods. Such an apportionment would be required where, for example, the company concerned was a close company for only part of an accounting period. **(6)**

The surcharge is not to apply to any income which a company is by law precluded from distributing. **(7)**

Example (Figures (in euro) used in this example are for indicative purposes only)

Investment income	100	
Case I (standard)	100	
Excepted trading income	100	
Standard rate charges	60	(S.243A)
25% charges (excepted trade)	20	(S.21A)
Non-trade charges	50	(S.243)

(assumed the company is a service company)

• **Calculation of distributable E & I income**

(1) Income of the Co. for the accounting period

Case I (standard rate)	100	
Less charges (S.243A)	60	40
Case I excepted		100
Investment income		100
Income		<u>240</u>

(2) E & I income for the accounting period

240 x 100/300	80	
Less non-trade charges	<u>50</u>	
	30	
Less tax @ 25%	7.50	
Distributable E & I income	<u>22.50</u>	
Less 7.5% for trading income	1.69	(Subsection (5A)(b))
	20.81	

• **Calculation of distributable trading income**

Trading income is

Income	240
Less E & I income (before non-trade charges)	80
	160
Less excepted charges	<u>20</u>
Trading income	140
Less CT 40 @ 12½% }	
100 @ 25% }	<u>30</u>
Distributable trading income	110

Summary

	Case I standard	Case I excepted	Investment
Income	100	100	100
Charges	<u>60</u>	<u>20</u>	<u>50</u>
	40	80	50
Tax	<u>5</u>	<u>20</u>	12.5

Distributable	35	60	37.5
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Calculation of surcharge under **section 441**:

Distributable E & I income	20.81	
50% of distributable trading income	55	
	77.50	
Distributions (say)	<u>30.00</u>	-
Surcharge on	43.50	
	43.50 @ 15%	<u>6.52</u> (S.441(4A)(a))
Surcharge		6.52

435 Information

Summary

This section empowers an inspector by written notice to request information to enable him/her to implement the provisions relating to close companies and it requires companies and individuals to supply the information. The inspector may require the person in whose name shares are registered to state the name and address of the beneficial owner of the shares. The inspector may also require a company to supply him/her with the names and addresses of persons to whom bearer securities were issued and he/she may require those persons to furnish him/her with information to enable him/her to determine the names and addresses of the beneficial owners of the security.

Details

An inspector may require a close company or one which seems to him/her to be a close company to supply such particulars as he/she deems necessary for the purposes of this Part. (1)

A registered shareholder must supply, when required by written notice, the name and address of the beneficial owner of the shares if the shareholder is not the beneficial owner. (2)

The section applies to loan capital as it applies to shares. (3)

An inspector may, by notice in writing, require a company, which he/she considers to be closely held, to furnish particulars of bearer securities (which includes various forms of indebtedness as well as promissory notes issued to a loan creditor of the company) issued by the company and the names and addresses of the persons to whom the securities were issued and the amount in each case. Any such person selling or transferring the securities is obliged, when required, to furnish information as to the name and address of the person to whom the securities were sold or transferred. (4)

CHAPTER 2

Additional matters to be treated as distributions, charges to tax in respect of certain loans and surcharges on certain undistributed income

Overview

Chapter 2 of **Part 13** contains a number of anti-avoidance measures aimed at ensuring that closely held companies are not used to either shelter income which would be taxable

at the higher rate if distributed to participators or to withdraw profits from such companies in a tax efficient manner.

Sections 436 and 437 extend the meaning of “distribution” to ensure that certain benefits provided to participators of close companies are taxable and that profits withdrawn from companies by certain parties in the guise of interest are treated as the distribution of profits. **Section 436A** counters attempts to transfer funds from close companies on a tax-free basis to shareholders or family members using trusts and other such settlements.

The withdrawal of profits from close companies in the guise of loans is countered by imposing an income tax charge on the company at the standard rate on the grossed up equivalent of the loan (**section 438**). Where a company releases or writes off such a loan, the amount written off is to be taken into account in calculating the total income of the person who benefits from the write off for the purposes of charging that income to the higher rate (**section 439**). Finally, to counter the tax avoidance device of accumulating profits in close companies rather than distributing them to shareholders in whose hands they would attract income tax at the higher rate, the Chapter imposes a surcharge of 20 per cent on undistributed investment and estate income of close companies (**section 440**) and a surcharge of 15 per cent on 50 per cent of undistributed professional and service income and a surcharge of 20 per cent on the undistributed investment and estate income, of service companies (**section 441**).

436 Certain expenses for participators and associates

Summary

This section extends for close companies the meaning of “distribution”. The purpose of the section is to secure that expenses incurred by a close company in providing certain benefits for participators are to be regarded as distributions where these benefits are not chargeable under **Chapter 3 of Part 5** (that is, the provisions relating to the taxation of benefits in kind). The section does not apply to expenses incurred in providing pensions and death and retirement benefits.

So far as the paying company is concerned, this section does not materially alter its tax liability. Expenses which are distributions are prohibited as deductions in computing income for corporation tax by **section 76(5)(a)**.

This section does, however, affect the position of the person who benefits by the expenditure. Where this person is a company, then, unless one company is a subsidiary of the other or both are subsidiaries of a third company and the benefit is the passing of assets or liabilities between the companies, the amount of the expenditure is a distribution and carries a tax credit. The aggregate of the distribution and the tax credit thus, for example, ranks as “franked investment income” for set-off of losses, or is included in “distributable income” for the purpose of a surcharge on undistributed income. Where the person is an individual, his/her income tax liability may be affected by the section, either favourable or unfavourably depending on the individual’s tax position. He/she may be entitled to claim payment of the tax credit or, on the other hand, he/she may be liable to higher rate tax on the aggregate of the distribution and its tax credit.

Details

In the case of a close company, the meaning of “distribution” is extended to include the amounts so treated by this section. (1)

A reference to a participator includes a reference to an associate of that participator. Also a participator in a company which controls another company is regarded as a participator (2)

in that other company.

Where a close company incurs expense in providing benefits or facilities for a participator, the company is regarded as having made a distribution to the participator of an amount equal to the amount of the expense, to the extent that the company is not reimbursed by the participator. (3)(a)

Excluded from this rule is an expense incurred by a close company in the provision of benefits or facilities for a person who is chargeable to income tax under Schedule E in respect of the expense. Also excluded is an expense incurred in providing pensions, annuities, lump sums, gratuities or other similar benefits for dependants on the death or retirement of directors or employees. (3)(b)

A proper apportionment is to be made of expense incurred by a close company partly in the provision of benefits or facilities caught by this section and partly for other purposes. The valuation provisions of *section 119* are applied to a benefit or facility to which this section applies. (4)

This section does not apply where the company and a participator also being a company are both resident in the State, and one is a subsidiary of the other or both are subsidiaries of a third resident company. This exclusion, however, does not apply unless the benefit consists of the transfer of assets or liabilities between the company and the participator. (5)

A company is regarded as a subsidiary of another company if it is a 51 per cent subsidiary (see *section 9*), that is, if the parent company owns, directly or indirectly, more than 50 per cent of the ordinary share capital of the other company. However, this is not to be the case where the shares are held as trading stock or where the shares are shares of a non-resident company and, accordingly, the section applies in such a case. (6)

Provision is made to counter the possibility of 2 or more closed companies entering into an arrangement to make payments to one another's participators in order to avoid an item being treated as a distribution under this section. (7)

436A Certain settlements made by close companies

Summary

The purpose of this section is to counter attempts to transfer funds from close companies on a tax-free basis to shareholders or family members using trusts and other such settlements. The section deters such attempts by providing that where a close company transfers money or money's worth under a settlement set up by the company for the benefit, or potentially for the benefit, of a shareholder or family member the transfer is deemed to be a distribution by the company to the trustees of the settlement. This means that the company is required to deduct dividend withholding tax of 20 per cent of the amount settled under the trust. Furthermore, where funds settled by a close company on a trust are subsequently distributed from the trust, the section provides that the shareholders or family members to whom such funds are transferred will be chargeable to income tax at the marginal rate on amounts received. The provisions apply to funds transferred on or after 21 January 2011.

Details

Subsection (1) provides definitions for 'member', 'relative', 'relevant settlement' and 'settlement'. A 'relevant settlement', in relation to a close company, is any settlement (within the meaning of *section 10*) made by or on behalf of the close company other than a settlement made for the exclusive benefit of a person(s) who is not a member of the company or a relative of such member and which does not allow for the provision of any benefit to such member or relative. The subsection also provides that any participator, (1)

being a member of a company which controls another company shall be treated as being also a participator in and member of that other company.

Subsection (2) provides that any amount in money or money's worth settled by a close company on or after 21 January 2011 in connection with a relevant settlement shall be treated as a distribution by the company to the trustees of the settlement. (2)

Subsection (3) provides that where an individual who is or was a member of a close company, or a relative, receives directly or indirectly an amount in money or money's worth from assets comprised in a relevant settlement in relation to the close company, so much of the amount as exceeds any consideration given by the individual, or relative, will be chargeable to income tax under Case IV of Schedule D. (3)

Subsection (4) makes provision for the section not to apply where it is demonstrated that the settlement was not made for tax avoidance purposes. (4)

437 Interest paid to directors and directors' associates

Summary

This section is designed to counter the tax avoidance device of withdrawing profits in the guise of interest. The section treats as a distribution interest in excess of a reasonable limit paid by a close company to a director or an associate of the director where the director has a material interest either in that company or in another company by which it is controlled.

Details

The term "interest" is defined in an "inclusive" way to encompass, in addition to what would normally be regarded as interest, any other consideration paid or given by the company for the use of money loaned or credit given. (1)

A person is regarded as having a material interest in a close company if the person, the person and associates of the person, or the person's associates by themselves beneficially hold either directly or indirectly more than 5 per cent of the ordinary share capital of the company. (2)

The section applies where interest is paid in an accounting period by a close company to a director (or an associate of the director) of the close company paying the interest or of any company which controls or is controlled by that company. The director (or the associate) must have a material interest in the close company paying the interest or in another company by which it is controlled. (3)

If the interest paid in the accounting period to a director or his/her associate exceeds the limit provided for, the excess is to be regarded as a distribution. (4)

The limit is in the first instance applied as an overall limit to the total interest paid in the accounting period by the company. Where there are 2 or more recipients, the overall limit is to be apportioned between them according to the respective amounts of interest paid to them. (5)

The rate of interest to be applied in determining the overall limit for allowable interest is 13 per cent per annum. To obtain the overall limit this rate is applied to the smaller of — (6)

- the total of the loans, advances and credits for the accounting period or, in the case of fluctuating amounts, the average for the accounting period, and
- the nominal amount of the issued share capital of the company at the beginning of the accounting period added to the amount of any share premium or similar account at that time.

The rate of interest may be varied by the Minister for Finance from time to time.

The provision in *section 436(7)* which counters the possibility of 2 or more close companies entering into an arrangement to avoid interest being treated as a distribution is applied for the purposes of this section. (7)

438 Loans to participators, etc

Summary

This section is designed to counter the device of withdrawing profits in the guise of loans. It imposes on a close company a charge to income tax at the standard rate on the grossed up equivalent of a loan or advance made by the company to a participator or an associate of the participator, if the company's business does not include the making of loans. The amount assessed is not regarded as a charge deductible for corporation tax purposes. There are provisions for giving relief to the company on due claim, in respect of any part of the loan or advance repaid to the company. The section does not apply where the loan does not exceed €19,050 and the borrower works full-time for the company or an associated company and has not a material interest in the company.

An amount on which the company has to account for tax under this section is not income of the recipient. If the loan is released or written off, however, it becomes income of the recipient in accordance with *section 439*.

Details

Where a close company (whose business does not include the making of loans) makes a loan or gives an advance to a participator, or an associate of a participator, the company is to be assessed to income tax at the standard rate on the grossed up amount of the loan or advance for the year of assessment in which the loan or advance is made. The amount assessed is not to be regarded as a charge deductible for corporation tax purposes. (1)

A close company is to be regarded as making a loan to any person who incurs a debt to the company or where a debt due from a person to a third party is assigned to the company. Excluded are debts for the supply of goods or services in the ordinary course of the business of the close company unless the credit given exceeds 6 months or is longer than the period normally given to the company's customers. (2)

The section is not to apply where the total of all loans or advances by the close company or an associated company (including loans or advances to the borrower's spouse or civil partner) does not exceed €19,050 and the borrower not only works full-time for the company or an associated company but also has not a material interest in the company. However, if the borrower acquires such a material interest, the outstanding amount of any loan or advance is treated as coming within the scope of the section. (3)

Relief to a company assessed to tax under this section is provided for in respect of any part of a loan or advance repaid to the company. The relief must (notwithstanding the general time limit for making a claim for a repayment of tax contained in *section 865*) be claimed within 4 years from the end of the year of assessment in which the loan or advance is repaid. (4)

Circumvention of the section by the interposition of an intermediary between the company and the borrower is prevented. For example, arrangements could be made for a close company to make a loan to which this section would not apply, and for some person (not the close company) to make a payment or transfer property to a participant in the close company or to an associate. Unless the money or property received by the participator is taxable as his/her income this subsection ensures that the section applies (5)

to the original loan as if the original loan had been made by the close company to the participator or associate.

The section is extended to cover a loan made by a close company to another company acting in a representative capacity or to a company resident outside the EU or United Kingdom. (6)

A participator in a company which controls another company is regarded as a participator in the other company. Also imported is the definition of “material interest” contained in *section 437(2)*. (7)

For the purposes of this section, a registered industrial and provident society is treated as a close company if it would be such but for the exclusion of such societies contained in *section 430(1)(b)*. Accordingly, loans and advances made to a participator in such a registered industrial and provident society (if it is a close company following the application of the rules contained in *section 430* as modified by this provision) may be subject to a charge to tax under this section. (8)

Example

A close company makes a loan of €8,000 to a “participator”. The company must account for income tax as if the loan were a net annual payment after deduction of tax, that is

Grossed-up loan (8,000 x 100/100 – 20)	€10,000
Income tax at 20%	<u>€2,000</u>
Net loan	<u>€8,000</u>

If the loan is repaid the company may claim relief in respect of the income tax which applied to the loan, for example, if the net loan €8,000 was repaid in a later accounting period the company would obtain relief of €2,000.

438A Extension of section 438 to loans by companies controlled by close companies

Summary

This section brings within the scope of the close company charge to tax on loans to participators a case where the close company does not itself make the loan but sets up or acquires a subsidiary to make the loan to the participators in the parent close company. This provision applies regardless of the residence status of the various companies making the loans.

Details

A “relevant arrangement” is defined as an arrangement, the main purpose, or one of the main purposes, of which is to avoid or reduce a charge under *section 438*. (1)

Brought within the ambit of *section 438* is a loan made by a company to participators in the Irish close company where the Irish close company controls (*sections 432* gives the meaning of “controls”) the company making the loan. (2)

The application of *section 438* is also extended in circumstances where the loan is made to the participators in the Irish close company before the company making the loan is acquired by the Irish close company. (3)

The application of *section 438* is further extended in circumstances where a loan is made to a participator, or an associate of a participator, as a result of a relevant arrangement entered into on or after 18 October 2018. (3A)

The above provisions are applied also to a case where two or more close companies acquired or set up the company which makes the loan to the participators. In such a case each close company is treated as controlling the lending company and making a loan on the appropriate portion of the loan made by the lending company. (4)

These provisions do not apply where it is shown that no persons has made any arrangements which results in a connection — (5)

- between the making of the loan and the acquisition of control, or
- between the making of the loan and the provision by the close company of funds for the company making the loan.

In this regard, the close company provides funds if it directly or indirectly makes any payment to, transfers any property to, releases or satisfies (in whole or in part) a liability of, the company which makes the loan. The intention here is to limit the application of these provisions to cases where a loan by the controlled company is clearly related to an application of the controlling company's own funds.

Provision is made for determining the answers to a number of questions raised by the provisions of *section 438* which have to be asked of the company which “makes the loan” which is the target of the taxing provisions of *section 438*. Accordingly, it is made clear that for the purposes of providing answers to these questions the company which “made the loan” is the company which — (6)

- actually made the loan or advance to the participators, or
- on the incurring or assigning of a debt, is regarded as having made a loan.

The provisions of *section 438(2)* are extended to companies which are not close companies. For example, where a debt is assigned to a non-resident company controlled by an Irish close company, the debt is first treated by *section 438(2)* as adapted by this subsection as a loan made by the non-resident company. The loan so treated may then be treated by *subsection (1)* as a loan made by the Irish close company. (7)

The provisions of the section are to be construed as one with *section 438*. (8)

439 Effect of release, etc of debt in respect of loan under section 438

Summary

This section provides that where a company which has been assessed to income tax under *section 438* releases or writes off the whole or part of the debt created by the loan or advance, the person benefiting by that release is regarded as having received at the time of the release income of an amount which after deduction of income tax at the standard rate is equal to the amount written off or released. For example, if the amount of the debt written off is €8,000 and the standard rate is 20 per cent, the amount to be treated as income of the person who benefits will be —

$$€8,000 \times \frac{100}{100-20} = 10,000$$

The section, however, provides that the income tax so attributed is not repayable and that the amount treated as income is not charged to income tax at the standard rate but is included in total income chargeable to tax at the higher rate, subject to a credit for the tax at the standard rate. The amount released is not available to relieve the recipient of any obligation to account for tax on any annual payments made by him/her.

Details

Where a company, which has been or is liable to be assessed under *section 438* in respect of a loan or advance, releases or writes off the whole or part of the debt thus created, the person to whom the loan or advance was made is regarded, for the purposes of computing his/her total income, as having received at that time income of an amount (1)(a)

which after deduction of income tax at the standard rate is equal to the amount released or written off.

The income tax notionally deducted under this procedure is not repayable. (1)(b)

The income tax so notionally deducted is not available to relieve the recipient of any obligation to account for tax on annual payments made by him/her. (1)(c)

In respect of any part of the amount released which is charged at less than the standard rate of income tax the tax credit is not to exceed the amount of tax charged, and in respect of any part of the amount released which is charged at standard rate or higher rate the tax credit is equal to tax at the standard rate on the amount so charged. (1)(d)

Where a loan to which *section 438* applies was made to a person who has died or to the trustees of a trust which has terminated, and all or part of the loan is written off, the deemed income represented by the debt released is regarded as income of the estate or the beneficiary, as the case may be, at that time. Where the loan is written off to the benefit of the estate of a deceased person which is under administration, the income is treated as chargeable to income tax at the higher rate. (2)

This section and *section 438* are to be construed together. (3)

440 Surcharge on undistributed investment and estate income

Summary

This section provides for an additional charge of corporation tax (referred to as a “surcharge”) on close companies at the rate of 20 per cent of the excess of the aggregate of the distributable investment income and the distributable estate income over the distributions made for an accounting period. There is no surcharge where the excess is €2,000 (€635 for accounting periods ending on or before 31 December 2012) or less and marginal relief is provided where the excess is slightly more. There are provisions to prevent the relief being abused by the setting up of a number of associated companies.

The amount on which the surcharge is made is not to exceed the accumulated undistributed income at the end of the accounting period with the addition of any transfers to capital reserves, bonus issues or other transactions on or after 27 November, 1975 which would reduce the accumulated income available for distribution.

Section 434 provides for the definition of terms used in this section and for the calculation of the various amounts referred to (and should be referred to in calculating any surcharge).

Details

An additional charge of corporation tax at the rate of 20 per cent is imposed on the excess of the distributable estate and investment income over the distributions for the accounting period. (1)(a)

There is no surcharge where the excess, in the case of a single company or a group of associated companies, does not exceed €2,000 (€635 for accounting periods ending on or before 31 December 2012). Marginal relief is provided where the excess is somewhat more than €2,000. (1)(b)

Example

If the company shown in the example below does not make any distribution in the accounting period to 31.12.2013 and before 1.7.2015 does not pay a dividend for that accounting period it will be surcharged as follows —

Distributable investment and estate income	€30,000
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Distributions	<u>NIL</u>
Excess	€30,000
Surcharge 20%	€6,000

If the company makes a distribution of €28,500 for the accounting period the position will be —

Distributable investment and estate income	€30,000
Distribution	<u>€28,500</u>
Excess	€1,500

As this is less than €2,000 there is no surcharge.

If on the other hand, the company distributes €27,600 the surcharge will be —

Distributable investment and estate income	€30,000
Distribution	<u>€27,600</u>
Excess	€2,400
Surcharge 20%	€480

but the liability is restricted to 4/5ths (80%) of the excess over €2,000 that is 4/5ths (80%) of (€2,400 – €2,000) = 4/5ths (80%) of €400 = €320 and this is the amount which will be payable by the company. (It should be noted that marginal relief runs out where the excess exceeds €2,666).

The amount on which the surcharge is made cannot exceed the accumulated (2) undistributed income at the end of the accounting period after taking account of any transfer to capital reserves or bonus issues or any other transaction occurring on or after 27 November, 1975 which would have the effect of artificially reducing such accumulated income.

In applying **subsection (1)** to an accounting period, a dormant associated company is to (3) be disregarded if it was dormant throughout the accounting period (or dormant throughout the entire part of the accounting period for which it was associated).

An associated company must be counted for the purposes of the surcharge even if it was (4) an associated company for part only of the accounting period concerned. Two or more associated companies of another company are to be counted even if they were associated with that other company for different parts of the period.

The surcharge is to be charged for the earliest accounting period which ends at a time (6) which is 12 months or more after the end of the accounting period in which the surcharge arose. The surcharge is treated as corporation tax of that period. If, however, there is no such later accounting period, the surcharge is to be charged for the accounting period in which it arises.

The corporation tax provisions regarding assessment and collection apply to the (7) surcharge.

A company aggrieved by an assessment made under this section may appeal the (8) assessment by notice in writing to the Appeal Commissioners. An appeal must be within 30 days after the date of the notice of assessment. The Appeal Commissioners will hear and determine an appeal in the manner provided for in Part 40A of the Act.

A company may not appeal if they have not filed a self assessed return and paid the amount due in accordance with their own self assessment, (where the person was required to file a return).

441 Surcharge on undistributed income of service companies

Summary

This section is designed to counter avoidance of tax arising from the diversion into close companies of income (usually arising from professional activities) which would otherwise attract income tax at the higher rate. The device consists of the setting up of a company for the purpose of carrying on a profession, providing professional services or holding an office or employment. It may also take the form of the setting up of a company controlled by persons engaged in a profession, etc for the purpose of carrying on a business of providing services or facilities for those persons. The profits of the company are withheld from distribution and therefore bear tax at the company tax rate rather than at the personal tax rates to which the profits, if distributed, would be liable in the hands of the shareholders. As these shareholders usually are liable at rates of personal tax which exceed the company tax rate the non-distribution results in loss of tax revenue. The section counters this method of tax avoidance by imposing a surcharge of 15 per cent on 50 per cent of the company's undistributed professional and service income and a surcharge of 20 per cent on the company's undistributed investment and estate income.

Details

A “service company” is — (1)

- a close company which carries on directly a profession or the provision of professional services or which has or exercises an office or employment,
- a close company which provides services or facilities of any nature to such a company, to an individual carry on a profession, to a partnership carrying on a profession, to a person who holds or exercises an office or employee, or to a person or partnership connected with any such person or partnership.

Excluded are genuine cases where the services or facilities are provided for persons not connected with the company.

A company is not a service company unless the principal part of its income chargeable under Cases I and II of Schedule D and Schedule E is derived from specified activities, that is — (2)

- carrying on a profession,
- providing professional services,
- having or exercising an office or employment,
- providing services or facilities (other than the excluded services referred to above) to such person or partnership as is referred to above, or
- any 2 or more of the activities so specified.

A partnership is to be treated as connected with a company or individual (and vice versa) if any one of the partners is connected with the company or individual, and a partnership is to be treated as connected with another partnership if any one of the partners in it is connected with any one of the partners in the other. (3)

A 15 per cent surcharge is imposed on the undistributed income of a service company. In computing the amount by which the distributable estate and investment income of the company exceeds the distributions made, 50 per cent of the total amount of the distributable trading income of a service company is to be excluded. (4)(a)

An increased surcharge of 20 per cent applies to an amount of the excess, being an amount which is not greater than the excess of the aggregate of — (4)(b)(iii)

- the distributable investment income, and
- the distributable estate income,

over the distribution of the company, for the accounting period.

Example

The accounting period of a company is the 12 month period ending on 31 December 2013. The company does not distribute all its distributable income. Its respective income and distribution position is —

Distributable income (DI)	€10,000
Distributable Investment Income (DII)	€3,000
Distributable Estate Income (DEI)	€4,000
Distribution for year	€6,000

1. Calculate the aggregate of 50 per cent of the DI plus 100 per cent of the aggregate of the DII and DEI.

$$€5,000 + (€3,000 + €4,000) = €12,000$$

2. The amount subject to the surcharge is the amount by which €12,000 exceeds the distribution (€6,000) of the company. This amount is €6,000.

3. To establish how the amount is apportioned between the surcharges at the different rates, calculate the excess of the DII and DEI over the distributions

DII + DEI	€7,000
less distribution	<u>€6,000</u>
	€1,000

4. The surcharges are —

€1,000 @ 20%	=	€200
€5,000 (€6,000 – €1,000) @ 15%	=	€750
Total surcharge imposed	=	€950

There is no surcharge where the excess of the distributable income over the distributions, **(4)(b)(i)&(ii)** in the case of a single company or a group of associated companies, does not exceed €2,000 (€635 for accounting periods ending on or before 31 December 2012). Marginal relief is provided where the excess is somewhat more than €2,000.

Example

Excess distributable income as computed under this subsection	€2,200
Surcharge @ 15%	€330

However, the liability is restricted to 4/5 (80%) of the excess over €2,000, that is 4/5 (80%) of (€2,200 - €2,000) = 4/5 (80%) of €200 = €160 and this is the amount which will be payable by the company. (It should be noted that Marginal relief runs out where the excess exceeds €2,461).

The provisions of **subsections (2) to (7) of section 440** are applied to the surcharge under **(5)** this section.

The provisions of **section 434(2), (3), (3A), (6) and (7)** regarding the distributions to be **(6)** taken into account for the purpose of computing a surcharge are applied for the purposes of the section. The provisions of **section 434(1)**, which defines the distributable income of a company for an accounting period and **section 434(5A)** which defines the distributable investment income and the distributable estate income of a company for an accounting period are also applied for the purposes of this section.