

[13.1.1] - Close Companies (objectives, implications for a company, definition and special provisions applicable)

[All references to legislation are with regard to the Taxes Consolidation Act 1997 (TCA) unless otherwise stated.]

A company **controlled** by a small group of persons may refrain from distributing its income or may make disguised distributions to these persons. Part 13 of the TCA is designed to counter the avoidance of income tax at the higher rate on investment and rental income (and certain Case II income) by allowing such income of close companies to be accumulated rather than distributed to shareholders in whose hands the distributions would attract income tax at the higher rate. Part 13 also contains provisions to counter avoidance of tax on loans, advances and other benefits provided by close companies to their shareholders or directors.

The close company provisions set out in the TCA 1997 have four main **implications** for a company and its participators/directors:

- Certain benefits-in-kind and expense payments to participators or associates will be treated as distributions [section 436 TCA].
- Interest in excess of a specified rate paid to directors or their associates will be treated as a distribution [section 437 TCA].
- Loans or advances to participators or their associates must be made under deduction of tax and, if the loan is repaid, the grossed-up amount is treated as income in the hands of the recipient [sections 438 and 439 TCA].
- A surcharge at the rate of 20% is imposed on the undistributed after-tax investment and estate income of close companies. Close "service" companies are also liable to a surcharge of 15% on one-half of their undistributed trading income [sections 440 and 441 TCA].

Subject to certain exceptions, a close company [which is defined in section 430(1)] is broadly a company which:

- (a) is under the control of five or fewer participators, or of directors who are themselves participators even if they number more than five or,
- (b) if on the full distribution of its distributable income, more than half of that income would be paid directly or indirectly to five or fewer participators, or to participators who are directors even if they number more than five.

Most Irish resident companies are 'close' companies. In most cases it will be clearly evident as to whether or not a company is a close company. A company owned by a small number of individuals (or a family company) will

usually be a close company while most quoted companies by their nature will be 'open' companies.

With regard to:

- (i) the tests for determining whether a company is a close company, see Tax Instruction 13.1.2,
- (ii) the provisions affecting the computation of the profits of a close company for corporation tax purposes, see Tax Instructions 13.2.5 and 13.2.6.

If a company is a close company, the special provisions applying can be classified as follows:

- (a) Provisions affecting the computation of profits chargeable to corporation tax,
- (b) Provisions affecting the definition of "distributions" and, therefore, inter alia, the amounts which are deductible as "charges on income" in computing a company's profits chargeable to corporation tax, see Tax Instruction 13.2.1 [section 437 TCA "Interest paid to directors and directors' associates" refers],
- (c) Provisions dealing with loans made by a company to a participator under which a company has to account for income tax, as if the amount of the loan was the after-tax amount of an annual payment, see Tax Instructions 13.2.3 and 13.2.4 [section 438 TCA "Loans to participators, etc" refers],
- (d) Provisions affecting the tax liability of the person to whom a loan within (c) above is made, if the loan is released or written off, see paragraph 9 of Tax Instruction 13.2.3 [section 439 "Effect of release, etc. of debt in respect of loan under section 438" refers],
- (e) Provisions imposing a surcharge on certain undistributed income of a company, see Tax Instruction 13.2.5 ["section 440 TCA "Surcharge on undistributed investment and estate income" refers] and Tax Instruction 13.2.6 [section 441 "Surcharge on undistributed income of service companies" refers].

Note: where a close company is subject, in the making of distributions, to any restriction imposed by law (e.g., by Act of The Oireachtas, Statutory Instrument etc. but not merely by reason of a provision in the Articles of Association of the company), regard is to be had to this restriction in determining the amount of income on which a surcharge is to be imposed under section 440 or 441. To the extent that the company could not make distributions out of any income without contravening that restriction, the income is not to be taken into account as "distributable income".

The provisions within (a) and (b) are interconnected, since under section 76(5) TCA, distributions are not a deduction in computing income from any source and section 243(1) TCA excludes distributions from the definition of charges on income.

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